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1964

Royal Commission on Banking and Finance

THE CANADIAN FEDERATION OF MAYORS
AND MUNICIPALITIES.

Hearings
held at
OTTAWA

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ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Monday,
October 29th,1962.

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Toronto, Ontario - Chairman

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Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
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--- At 9.15 the hearing commenced.

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J.A. Mongrain	- President
George S. Mooney	- Executive Director
Douglas H. Fullerton	
Eric Beecroft	- Director of Ottawa Bureau
Armand Turpin	-
R.J.P. Dawson	-
C.N. Kushner, Q.C.	-
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THE CHAIRMAN: We will now resume.

MR. MONGRAIN: Your Lordship and gentlemen, in the name of my colleagues, the mayors of Canada, I would like to thank you for giving us this opportunity to express the views of our municipalities on the relations of banking and finance with our local governments.

With your permission, I will ask our Executive Director, Mr. George Mooney, to take over since he has had the most to do with this submission that we are presenting to you this morning.

THE CHAIRMAN: Mr. Mooney?

MR. MOONEY: My Lord, perhaps I should introduce the group who are before you. There is the President of the Federation, J.A. Mongrain of Trois Riviere. To my far right is Mr. Douglas H. Fullerton, who has been co-opted by the Federation to assist in the preparation of certain sections of our submission and he is here as an expert on our behalf on certain questions pertaining to the marketing of bonds and matters related thereto if they should be asked. Then we have Mr. Eric Beecroft, who is the Director of our Ottawa Bureau. Then we have Mayor Armand Turpin of Hull on my immediate right. Then we have Mayor Mongrain on my left, and then Mayor Dawson of Mount Royal, Quebec, and then Mayor C.N. Kushner, Q.C., of West Kildonan, the immediate past president of the Federation. Then we have Mayor J.E. Lloyd of Halifax, Nova Scotia, and then Mr. J.S. Lowther, Commissioner of Finance for the City of Ottawa, who has

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participated in the preparation of the submission and he is also here as an expert witness, particularly on matters pertaining to the procedures and the mechanics. I am George Mooney, the Executive Director.

Now, as I understand it, gentlemen, you have ploughed through the submission. It has not been the custom, nor is it our desire unless you should desire us to do so, to review or summarize the submission. We think that it is in fairly good systematic order.

We have endeavoured in this submission to place on the record data and points of view pertaining, we believe,to the terms of reference of the Royal Commission on Banking and Finance in so far as the municipal governments of Canada are concerned.

We have, we think, pretty well covered the waterfront and I understand that you probably will want to direct some questions to us. I shall endeavour wherever possible to deal with the questions which may be raised, but with your permission I would like the opportunity to call upon others who comprise the Federation group to deal with any specific matters on which I think their information might be more complete and perhaps more informative than mine.

THE CHAIRMAN: Are the rural townships part of your organization?

MR. MOONEY: Yes, indirectly they are, My Lord. As we have explained in the early part of the submission, the Federation is a national

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MR. MOONEY: Yes, indirectly they are, My Lord. As we have explained in the early part of the submission, the Federation is a national

organization of municipal governments and it has two types of members; one type might be described as directly affiliated with municipal governments, and there are the larger cities and towns, and with a cross section of these smaller communities across the country, and then the provincial unions and associations across the country, and it is the provincial unions which embrace within their membership rural and township organizations which are indirectly within the framework of the general activities of the Federation.

THE CHAIRMAN: Very well. Thank you. It is not necessary to make any preliminary statement on the issues raised in your brief. As you have mentioned, we have all read the brief with great interest and I think that most of the members of the Commission will ask questions and most of the major points will emerge in the course of discussion. We will now proceed.

COMMISSIONER HARROLD: Perhaps I should start off with a question on the very first section, and this is the section on recommendations and suggestions on page 2.

Now, section 7 (c), the first part of that particular paragraph; I understand the second part, but I would like a little more explanation as to what is meant by the first part. It says:

"Present federal tax law puts municipalities and other governments at a disadvantage in comparision with corporations

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"Present Federal tax law puts municipalities and other governments at a disadvantage in comparison with corporations

who can charge bond interest as an expense."

And then it says:

"This means, in effect, that corporate taxes are reduced by approximately one-half of the interest paid."

I am rather at a loss to know just exactly what that means. Can you explain that further?

MR. MOONEY: I would like to ask Mr. Fullerton to deal with that question.

MR. FULLERTON: Well, corporate borrowers can charge steady interest on bonds as an expense prior to calculating income tax, so that they can therefore tend to make bond interest as being partially paid for by the Federal Government in a sense, and if they pay 6 per cent bond interest it is really 3 per cent in terms of tax income, whereas the corporations and the municipalities do not operate under that same advantage.

COMMISSIONER HARROLD: I am at a loss to see where the disadvantage is as far as municipalities are concerned. They are not in competition with corporations.

MR. FULLERTON: They are in the bond market.

COMMISSIONER HARROLD: Well, the second paragraph refers to the investors or the people who are going to buy your bonds. Does that mean that the first sentence refers to the investors, too?

MR. FULLERTON: No, there are two separate

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MR. FULLERTON: No, these are two separate

points here. The first is that the corporate borrowers have an advantage by being able to deduct interest paid from their taxes, and the second point is that the investors who own stocks can claim a tax credit on their dividends on these stocks.

COMMISSIONER HARROLD: Well, I understand that particular part, but I am still not quite clear as to what effect it has on the municipalities.

MR. LLOYD: May I speak to this as an accountant rather than a mayor? I would like to make a general observation, if I may. The first few pages are an attempt at summarizing, and perhaps the tremendous value of this document -- which is on the following pages -- may suffer by this attempt at summation, and I do trust that the Commission -- as I mentioned to my group last evening -- will not think that the summary would give you all the benefits of the submission which we hope to bring to the Commission.

As I would interpret the first part of (c) -- and I think it is enlarged on through the brief -- it says:

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deductible and therefore they are in the market seeking capital funds by way of borrowing in competition with municipal and other governments, and they can make it more attractive to the investor because they have this feature of tax deduction, and I think that it is in that sense that it is meant.

THE CHAIRMAN: Not to the investor?

MR. LLOYD: To the borrower, I am sorry. The private corporate borrower says, "Well, let us get as many bonds as we can since we can take these as tax deductions," and it becomes related to the costs of their equity capital, and this is particularly true of utility corporations.

MR. MOONEY: We are trying to suggest that there are two types of borrowers, as far as this paragraph is concerned. One, the private corporation and the other the public body of the municipality, and that because of the existing federal tax laws with respect to a private borrower, he is able to deduct that as part of the cost of his borrowing from his income tax returns and this decidedly puts municipal government at a competitive disadvantage as compared to the private borrowers who, in the last analysis, are able to borrow their money cheaper than the municipal governments because they are able to charge back part of the cost to the federal government through the income tax.

THE CHAIRMAN: The municipalities don't

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THE CHAIRMAN: The municipalities don't

pay income tax.

MR. MOONEY: That is true, but they are borrowing the same dollar.

COMMISSIONER LEMAN: The higher the tax rate on corporations the more advantage the corporations would have, is about the way the argument runs.

MR. FULLERTON: Yes.

MR. LLOYD: I am sure that the Commission sees the point.

COMMISSIONER GIBSON: It sounds as if it is an advantage to pay taxes.

MR. LLOYD: It may sound that way, but it is a fact that here is a group of people who want some money for a purpose, and in making their decisions they are bound to look at the tax position. I haven't found one of my clients that doesn't, and I am sure that many of the clients of any consultant looks at the question of the tax position. This influences their decision as to how much private stock, how much common stock, and how much borrowed money they are going to go into the market for, and it is in this sense I think that this summation is made.

COMMISSIONER HARROLD: I am still not quite clear. It is from the point of view of the borrower, but if it was from the point of view of the attractions to get money, I can go along with the second part, but I am still not quite clear as to how they are at a disadvantage as compared to corporations. If the municipalities

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are not paying taxes, surely from the point of view of the corporation or the municipality there is no disadvantage from their point of view.

MR. LLOYD: A disadvantage in the sense that it costs us more money because our competitors are seeking this for their own purposes and are willing to pay a higher price, because they can use it as a tax deduction.

MR. KUSHNER: I think that the point made by you is correct up to a point; in other words, from the point of view of the investor who buys the bonds, regardless of whether it is a corporate or a municipal bond he will get the same tax position, so at first glance there would be no difference, but what we are trying to say -- at least, I gather this from the way I interpret the first clause -- is that since it makes very little difference to the investor, tax wise, and he may be interested in a corporate bond that may give him some other advantages as against a municipality bond and this drives our costs up due to the pressure of the corporate bonds also being on the market, so that from the investor's point of view at first glance it wouldn't make any difference, but if he has an advantage in a corporate bond as compared to ours, we are in competition; not because there is any merit in one or the other, but the investor has an advantage in that with a group of corporate bonds their interest is deductible as a tax item, whereas ours is not. We are placed in unfair

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competition here in the open market and it is a little narrower than the competition you are trying to place, and this is all that we had in mind.

COMMISSIONER MACKINTOSH: I would suggest the only valid point you have here is that the corporate borrower may be led by the tax deductibilty feature to be a little less prudent in trimming his demands on the market?

MR. KUSHNER: That is quite right.

COMMISSIONER MACKINTOSH: I think it is not well stated as a disadvantage; perhaps they do price on the market to some degree because of that, but I can see no other valid point in this first part.

MR. TURPIN: Don't you think that if the investors are offered, say, 6½ or 7 per cent bonds as against ours at 5¼ or 5½ per cent, that in reality the corporations are placed in a far better position because half of their interest expenses on these bonds are charged against their tax to the government. They are able to raise the interest on their bonds as against ours by one-half or three-quarters of a per cent.

THE CHAIRMAN: Is there any evidence that they do that? Why would they do that? It costs them more if they do what you suggest.

MR. KUSHNER: Yes, but there is this difference; let us take the hypothetical case of a corporation which wants to borrow money and is prepared to say 6 or 7 per cent, you can't from the investor's point

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of view -- take the borrower as compared to the municipality; the municipality has to go to the market and has to come up to that, otherwise the investor will be attracted more to the corporate bonds.

The net result is this, though; that whereas our 6 per cent, or whatever rate you put on it, is 100 per cent expense to us, I think the rate of interest on a corporate bond may be only part of that as an expense, because part will be deductible as an income tax item anyway, so that difference in the two places the municipality at a disadvantage and he only pays a part, depending on his tax rate. There is that difference, I think, Dr. Mackintosh, at any rate. It may only be a small difference, but there is enought in the total.

COMMISSIONER MACKINTOSH: Another point is that you would not embrace joyously the obvious way of remedying this?

MR. LLOYD: There are many ways of doing it; I am not sure what you are referring to.

COMMISSIONER MACKINTOSH: Putting the taxes on municipal revenue.

MR. LLOYD: No, this is the point I tried to make earlier. I made this statement last evening, that I was afraid that the first few pages, which would attempt to summarize, would in some way under-sell the great value of the contents of the brief at times, and I will illustrate this with a reference. If you would turn to page 0-1,

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Section 1, gentlemen, you will see that it says:

"In comparing their position with corporate borrowers, the municipalities (and, presumably, the provinces) feel that they merit special consideration by the Federal Government. Interest on corporate bonds is a cost-sharing business and a deduction from income before taxes. A corporation therefore tends to regard the coupons of a bond as half chargeable against income tax. While it is technically incorrect to argue that corporate borrowing is actually subsidized by the federal treasury, the effect is somewhat similar and tends to tilt corporations towards bond issues rather than equity financing. This, in turn, increases the pressure on the market generally and may raise costs for other borrowers."

We are mindful of the fact that there is another Royal Commission on Taxation, and what effects that might have on this we don't know, but in our position I think we are quite properly drawing this sector to your attention.

COMMISSIONER BROWN: It seems to me that there are two points you are trying to make here; one is that corporations in a rising bond cost market are at an advantage, in your opinion, because of this tax thing?

MR. LLOYD: Yes.

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MR. LLOYD: Yes.

COMMISSIONER BROWN: And the second point is that corporations, because they can charge off interest as an expense, tend to increase the number of bonds in the market quantitatively as well as qualitatively?

MR. LLOYD: Yes. There is the disadvantage on the one hand of a limitation on sources of funds.

COMMISSIONER LEMAN: Mayor Lloyd, have you ever seen figures with respect to the average capital structure of corporations when income tax was at an average of 10, 12 or 15 per cent as against what it is now, an average corporation tax of 50 per cent?

MR. LLOYD: No, I have not, sir.

COMMISSIONER LEMAN: I believe the record shows it has not changed very substantially as a result of the higher income tax.

MR. LLOYD: If the Honourable Chairman will permit an observation on a matter of statistics, I have found in my experience that this generally can be rather dangerous. I was reminded of a story Lord Amory told recently in Fredericton: that statistics should be used like a drunk uses lamp posts, for support and not enlightenment. I find it very difficult from our rather modest position in municipalities to unravel all the intentions of references to statistics in a general way. There are volumes written on the subject. I think it can be clearly stated for our purposes that this circumstance does create a greater demand for bonds among the municipalities. It is the only way they can borrow money in Canada to a substantial degree, and their borrowing is limited by this factor. That is all we say. We say no more than that.

MR. MOONEY: Mr. Chairman, I think Mr. Fullerton would like to make a further observation.

MR. LLOYD: Yes. There is the disadvantage on the one hand of a limitation on sources of funds.

COMMISSIONER LEMAN: Mayor Lloyd, have you [illegible] structure of corporations when income tax was at an average of 10, 12 or 15 per cent as against what it is now, an average corporation tax of 50 per cent?

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COMMISSIONER LEMAN: I believe the record shows it has not changed very substantially as a result of the higher income tax.

MR. LLOYD: If the Honourable Chairman will permit an observation on a matter of statistics, I have found in my experience that this generally can be rather dangerous. I was reminded of a story Lord Amory told recently in Fredericton: that statistics should be used like a drunk uses lamp posts, for support and not enlightenment. I find it very difficult from our rather modest position in municipalities to unravel all the intentions of references to statistics in a general way. There are volumes written on the subject. I think it can be clearly stated for our purposes that this circumstance does create a greater demand for bonds among the municipalities. It is the only way they can borrow money in Canada to a substantial degree, and their borrowing is limited by this factor. That is all we say. We say no more than that.

MR. MOONEY: Mr. Chairman, I think Mr. Ilerton would like to make a further observation.

MR. FULLERTON: It is in reply to Dr. Mackintosh's point about an alternative approach to taxing municipal income. I would personally suggest as an alternative that on a corporation bond the interest be deductible after tax. This would help corporations to a much higher extent in equity financing as it would free the bond market for municipal borrowers.

COMMISSIONER MACKINTOSH: Possibly that suggestion would find merit with the tax commission but I doubt that their major reason for doing it, if they should adopt that regulation, would be to improve municipal borrowings. Other factors would enter into it.

COMMISSIONER HARROLD: Perhaps we could go on to another question. I am interested in paragraph (f) on page A-2 of your brief. This is not the first time I have seen this in print but I should like to ask for a few examples of what you have in mind when you state it in this way:

> "The allocation of funds by senior governments for capital development projects reflect a built-in bias against the requirements for the rapidly growing urban areas."

As I understand it, the Federation of Mayors and Municipalities, represents, as stated in your brief, 350 cities, towns, villages, townships, a cross-section of municipalities of all kinds. In view of this I would be interested in knowing what you have in mind. I presume

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it is capital projects you are referring to there?

MR. LLOYD: Yes.

COMMISSIONER HARROLD: Would you give us a few examples of what you had in mind when you put this paragraph in?

MR. MOONEY: Mr. Chairman, this is thin ice. One could recite relatively recent examples of what we had in mind when the sentence was put that way, and one could go back over a long period of time to indicate that in terms of both the federal and provincial governments there is a certain tendency on their part. This tendency on the part of the senior governments, we say, is influenced by the composition of representation in these legislatures in the balance of rural as against urban representation, with the result there is a tendency to favour the rural needs of the nation rather than the urban needs of the nation.

THE CHAIRMAN: Do you not represent the rural as well as the urban?

MR. MOONEY: I do not think the Federation represents the rural in the complete sense that the Federation probably more accurately represents the urban communities of the nation, although this means the largest metropolitan cities to the smallest little cross-road hamlets. But we are not here now representing, for instance, the western wheat farmers or the potato growers of Prince Edward Island.

THE CHAIRMAN: No, but do you not represent the rural municipalities and rural townships?

MR. KUSHNER: Surely that does not prevent

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MR. KUSHNER: Surely that does not prevent

us, Mr. Chairman, from looking objectively at a problem.

THE CHAIRMAN: I was just wondering what the view of the rural townships would be on this question.

MR. KUSHNER: I think all that Mr. Mooney is trying to say, Mr. Chairman, is that due to the heavy imbalance with respect to representation in the various legislaturesand in the Parliament of Canada, an imbalance favouring the rural side, their objectivity is biased and their means of allocating capital funds is bound to be biased. What we are endeavouring to point out to the Commission is that the urban taxpayer, and in large our tax dollars come from the urban centres, not only has to pay for his own capital borrowings but, through federal and provincial progects, has to pay part of the tune in the rural areas of the country. We are not saying something has to be done that way, but we say when it is done that way it is another pressure on the urban municipalities.

COMMISSIONER HARROLD: I am aware of that but my question was: can you give us a few examples of what you have in mind?

MR. LLOYD: We could give you examples, sir. For instance, there is a gasoline user tax imposed in the Province of Nova Scotia. It is universally applied to all users whether, for instance, it is truck solely operating within a city or one operating on provincial highways, and so on. Despite this source of revenue, in the case of the City of Halifax there is a limited access highway being constructed and the minute it passes the boundary line --

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and it is one hundred per cent paid for -- by provincial law fifty per cent of the capital cost must be borne by the City of Halifax. This is very realistic. It costs us $1,200,000.00 currently.

On the other side of the coin, in attempting to deal with taxation and financing in the Province of Nova Scotia -- and I think this applies generally to other areas throughout Canada -- they measure the volume of real property assessments as the ability to pay. This, of course, assumes that in the large urban districts they have the same obligations to supply services as in the smaller villages and towns, despite the fact that in the smaller villages and towns the Royal Canadian Mounted Police may provide the police force, and the provincial government may build the main traffic arteries. Yet they use real estate as the measuring stick of the ability to meet obligations for education and highways.

COMMISSIONER HARROLD: You are really suggesting larger representation for the major cities.

MR. LLOYD: I think it is the orientation on the part of the provincial governments' finances forgetting, of course, a good many other considerations one could deal with. One could write a book on the subject of representation in the legislature.

THE CHAIRMAN: Well, the big municipalities have the great industrial and commercial assessment, something which is denied to the rural.

MR. LLOYD: Let us take the position of the County of Halifax. It has no industrial exemption.

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Boundary lines are slow in being changed. There seems to be a very determined attitude to go very slow on the subject of extended boundary lines. You have this experience, Mr. Porter, in Toronto. You say they have the industrial assessment. This, examined very carefully, is not such an advantage as sometimes appears to be seen, for it also creates demands for services. As elsewhere contained in this brief, you will have the industry located in the city but the employees of that industry residing in the dormitory county next door. But the dormitory county next door is the one feeling the pinch, and this is why we make this statement to you. It is just as much on behalf of the county government as it is on behalf of the city. It is wrong both ways.

COMMISSIONER HARROLD: Your main examples are highways and education?

MR. LLOYD: There are others.

MR. TURPIN: In the Province of Quebec the government subsidizes the construction of sewers and water works for the smaller communities, and it never does so for the larger cities or medium-sized cities. They do the same thing in respect to paving of streets. They never do it for the cities but they do it for the smaller communities. That might be an example.

MR. KUSHNER: If I may, Mr. Chairman, direct your mind again to the problem before this Royal Commission, the problem of banking and finance and not so much the division of the tax dollar, what

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COMMISSIONER HARROLD: Perhaps we could go on to the next topic. I was just interested in having this pointed up a little more. It is not the first time we have heard of it or talked about it. Perhaps we could go on to the topic of revenues. In paragraph (a) on page F-1 you say:

> "It has been suggested that municipal governments are not fully utilizing the property tax as a means to increase local revenues. This view is not shared by municipal administrators who feel that, generally speaking, property is now being taxed at a level beyond which it would be dangerous to go."

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The question is this. There is quite a variation, is there not, on the level of taxes in various cities and towns, and so on?

MR. MOONEY: Yes, there is quite a variation. May I say in reference to this, in as much as we are now discussing this section on the burden of municipal taxation, that we should like to correct page F-1. I have brought a correction with me.

COMMISSIONER LEMAN: It might be simpler if you could give us the exact wording of the correction.

MR. MOONEY: There are three fundamental corrections. First of all, there is a typographical error. In paragraph (c) in the eighth line the percentage figure of 31.4 is incorrect. It should read:

> "By level of government this income group contributed 22.8 per cent of the federal revenues, 25.8 per cent of the provincial revenues and 34.1 per cent of the funds raised by local governments."

At the conclusion of that paragraph the sentence should be concluded by reading:

> "....from which it can be concluded that the lower income group have a greater relative importance to the fund raising activities of municipal governments than to the fund raising of senior governments."

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> taxes are concerned the $7,000
> and over income group accounts
> for approximately 30 per cent of
> the total tax paid...."

We want to specify it as the "$7,000 and over income group".

COMMISSIONER HARROLD: Would you repeat that last correction, please?

MR. MOONEY: Yes. It is the first part of paragraph (f). It should read:

> "Insofar as local property
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I do not think it had anything to do with the question you were raising. This is merely a correction on the page.

COMMISSIONER HARROLD: I shall repeat my question. Is there not a considerable variation in the per capita tax amongst cities of comparable sizes?

MR. MOONEY: Yes, there is. It is not a wide variation but there is a variation. It is not uniform, per capita-wise, in every municipality, but there is a variation.

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MR. MOONEY: I do not think so. I should imagine there are some municipalities in this country that could stand, without danger, an increase in a property tax imposed, but generally speaking for most municipalities, and particularly for the larger municipalities across the country, we are of the view that the present taxes that are imposed by means of the property tax are pretty well at their peak.

COMMISSIONER HARROLD: May I ask one more question along the same line? How do you measure that, by tax arrears or just by objections to taxation?

MR. MOONEY: I would think there are several general measurements that one could apply. Tax arrears would be an indicator, and in some areas of the country there is quite a problem with respect to the basis of present property rates.

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One of the measurements we have indicated on the graph which follows page F-1. That applies to one city, namely, the City of Vancouver, wherein over the most recent five-year period total general municipal taxes have increased at a higher percentage than the average wages paid in that community. This is an indicator which we think has significance.

You have probably looked at that table, but the actual difference is 14 per cent as between the general taxation imposed and the average weekly wages and salaries based on the industrial composite index. If you want to measure the percentage it is 14 per cent, and we think this is of significance.

We think that the conclusions we have drawn from Professor Goffman's recent study on the burden of Canadian taxation indicates quite clearly that municipal taxpayers in the aggregate -- the majority of them -- are taxpayers whose annual incomes are less than $7,000. Quite a high proportion of them have an income of less than $4,000.

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The burden of the financial support for municipal governments is highly concentrated in that income group , and we believe that the capacity of that group to pay increased municipal taxes is marginal. We believe it is already very high in most municipalities across the country, and that any substantial increase in the local property taxes in these communities might very well be disastrous.

I use that word "disastrous" in the sense that it conceivably could make it uneconomic for people to continue to be home-owners. It might force people out of their present homes because the taxes are too high for them to bear. It might force them to go into a less expensive home. There are these kinds of considerations.

Also, Mr. Chairman, there are the political aspects of taxation. There is a great feeling on the part of local taxpayers against increases in taxes, and this has had its impact upon the thinking of those who comprise the political leadership of municipal governments.

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Mayor Lloyd wishes to say something further.

THE CHAIRMAN: Before you go on, Mr. Lloyd, there is a graph just before page G-1 which shows the curve of total taxation. Does that take into account the provincial payments to householders in Vancouver?

MR. DAWSON: Yes.

MR. MOONEY: In the case of Vancouver it does, sir, and it is mentioned under school taxation above.

THE CHAIRMAN: That is what is meant by "home-owner grants"?

MR. MOONEY: Yes. It is a purely provincial situation in British Columbia.

COMMISSIONER BROWN: I would like to ask one question with respect to this graph. When you talk about per capita taxes are you talking about per capita taxes over the whole tax roll, or per capita taxes only in regard to home-owner taxation?

MR. MOONEY: I would assume it is over the whole tax roll, but I am not in a position to give you an answer. There is no one here from Vancouver who can give us that answer.

COMMISSIONER BROWN: You are talking about what the individual pays, and this graph does not reflect what the individual pays.

MR. MOONEY: Oh, yes.

COMMISSIONER BROWN: If it is per capita over the whole tax roll it would also include industrial taxes.

MR. MOONEY: I am not in a position to say which of the two it is, but I would assume it is over the whole tax roll.

COMMISSIONER BROWN: Similarly, on page F-1, with respect to your reference to Professor Goffman, Professor Goffman makes it clear that he is talking about taxes paid by individuals, or by persons.

MR. MOONEY: Yes.

COMMISSIONER BROWN: But when you get down to paragraph (e) and paragraph (f), you refer to the figure of 70 per cent of all municipal taxes, and there you really mean all municipal taxes paid by all individuals?

MR. MOONEY: By everyone.

COMMISSIONER BROWN: Including industry and business? Your percentages, you see, refer only to taxes paid by individuals, so it is 70 per cent of all individual taxes paid by individuals.

MR. MOONEY: Yes, on the basis of Professor Goffman's study.

COMMISSIONER BROWN: So your sweeping statements are a little more definitive in that they are confined to the municipal taxes paid by individuals; is that correct?

MR. MOONEY: Yes, I would think so. These are put forward not as indicative of a situation, but only in the generalities in which we have tried to interpret them.

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catch you out. I just wanted to make clear what we are talking about.

MR. KUSHNER: To answer Commissioner Harrold's question I might point out that we are dealing with taxes across the country, and there are variations from place to place, but I can say this of my own municipality that even some of those people who have bought homes recently with the help of Central Mortgage and Housing -- we have concrete examples of this -- are on welfare, and, in fact, the municipalty has had to help them to make the payments on their houses. There are these cases cropping up, and I have evidence of it. This is indicative of what is happening, and we feel it is our duty to alert this Commission to this trend. As Mr. Mooney mentioned, some of these people are going to be driven away from their homes, and one day we are going to have to stop paying for the homes of people who are not employed.

COMMISSIONER HARROLD: Do you think this has something to do with the level of property taxation?

MR. KUSHNER: Well, it has in this sense, that we cannot go much higher, and the arrears are increasing. Our collections are now down to about 90 per cent. In some areas this trend is a little slower in showing up, but it is there. It is indicated in places where the standard of service has been lowered because people have refused to go on spending money for one thing or

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another. That is the best indication we have of where the taxpayer says: "I cannot afford it".

COMMISSIONER HARROLD: You agree that where it is necessary to do certain things it would be better to raise the money by other means than property taxation?

MR. KUSHNER: Yes, for one simple reason -- and I have had occasion to say this before, and I think it should be placed before this Commission -- that no matter by what means you try to collect the tax dollar it is either within the capacity of the taxpayer to pay it, or it is not within his capacity to pay it, but in the municipal tax circle that taxpayer has no choice. We constitute the only authority that can take away his property if he does not pay his taxes, so we are probably more sensitive to the position of the taxpayer than any other tax-collecting administration would be.

MR. TURPIN: If municipal taxes were the only taxes paid by the property owner it would be easy to answer your question, but the whole matter has now reached the point of diminishing returns. You have to keep in mind every other kind of tax paid, especially the provincial taxes and the federal taxes. Those have increased greatly during the past 25 years, and because they have increased the property owners are less able to face the payment of increased municipal taxes.

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MR. KUSHNER: This is just an aside, Mr. Chairman and gentlemen, but I think it might be

interesting to note that although provincial and federal revenues have increased over the past few years the percentage of actual taxation has not increased. Whereas municipal taxes have increased from 5 per cent, say, to 6 per cent, this has not happened to the same extent in respect to provincial and federal taxes. While our municipal taxes have gone up the federal taxes have not gone up in the same ratio.

MR. LLOYD: Mr. Chairman, the question was posed by Mr. Harrold, How do you measure it; how do you draw the conclusion that real property taxation has reached a dangerous point? I cannot find any knowledgeable person in the field of economics who has directed his efforts to this particular subject, Mr. Harrold. I would like to find one, because I know my own limitations in this field. I can only make some observations in answer to you, sir.

I think this Commission is looking not solely at things today, but it is looking ahead to the needs of Canada in the future. I think that we must recognize the impact of the population growth, and its relationship to the world as a whole. You must also recognize that urbanization has taken place in the sense that people are now seeking employment for themselves and their families in the larger urban districts.

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it did in earlier times in this country, and in many other countries, and this is due to automation and other things. I think that is recognized. There has been this shift towards living in urban districts.

This means that the older cities are faced with the necessity for substantial improvements. Many of them are faced with re-development of worn out sections. Many of them are trying to prevent the sprawl of industrial development and urban development along the main highways, and things of that sort.

However, we are finding that entrepreneurs wishing to undertake substantial new building do take a look at municipal taxes today. They look ahead 20 years to see what they will be up against. This discourages them from making such investments, and this, I think, is an indicator that your real property tax is beginning to have a discouraging effect on the entrepreneur, and this effect, therefore, hampers the municipalty's ability to prepare itself for the expanded kind of services that are going to be needed, and the improved and modernized services that are going to be needed.

This business of measuring the ability to pay for education on the basis of valuation of real estate leaves the city with the larger volume of real property to tax -- and, perhaps, the greater share of industrial and commercial taxation -- in this position, that the province does not assess

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it to the same degree as it assesses other municipalities, and so there is this imbalance. In this respect the measuring sticks used are the wrong ones. They will say that the ability of the city to pay is measured by what they called the equalized assessment, which is not equalized at all. The value of the assessment in the large city is compared with the value of the assessment in the township which is far away from that city. Land values in the two places are quite different.

I think you will find that this is expressed very realistically when you reach the point where property value is declining on the market because the buyers of property have not the income to service the necessary debt to purchase the property or a home. This then reflects itself in assessment values, and you get the law of diminishing returns operating.

I suggest to you -- and you are far more knowledgeable about economics than I am -- that a great many cities in Canada are in that position today, although not all of them. I cannot say that this is universally so. I think you will find many situations where the real property tax is discouraging investment, and is reaching the point where an attempt to collect more tax dollars results in a decline in tax revenue. It is only because the assessor is slow in reflecting the changing market values in his assessment that this is not apparent in some places yet.

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COMMISSIONER HARROLD: Are you saying that this entrepreneur that you are talking about, in making a choice between one city or another, does take this into consideration?

MR. LLOYD: Yes, and there is also a tremendous need for improvement in housing conditions in many parts of Canada.

THE CHAIRMAN: That may be so, and this sounds very familiar to me. I have heard it for the past 20 years, year after year, from the municipal associations and others, and in the course of time the provincial and the federal governments have in different ways attempted to relieve the situation such as by making grants which are derived from sources of revenue that the provincial governments, for example, have and which the municipalities do not have. The federal government has also done a great deal in welfare expenditures which has relieved the municipalities directly in many cases, and indirectly in others, of their burden. If the real property tax is entirely inadequate what tax do you suggest, and how are we going to get it?

MR. LLOYD: I say it is over-worked, Mr. Chairman. I say it has not got a place ---

THE CHAIRMAN: Are not all sources of taxation over-worked?

MR. LLOYD: I think that that is probably so.

MR. KUSHNER: But it is rather interesting,

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Mr. Chairman, having regard to the excellent background experience you have had in dealing with municipalities, to note, despite all these grants that the provincial and federal governments in one form or another have given to the municipalities, that the picture across Canada is that of the municipal tax dollar collected less than 50 per cent of it is left in the municipalities' hands. The rest goes to education and other things.

THE CHAIRMAN: I know, but the same thing can be said of the provincial and the federal fields. I noticed that in Parliament the other day it was pointed out that they could not reduce the deficit much beyond what they have because there are too many uncontrolled expenditures that they could do nothing about until some statutes were changed. Everybody is subject to this.

MR. LLOYD: I am going to resist the opportunity to answer you on this aspect because we are addressing ourselves to you as a Royal Commission on Banking and Finance, and the purpose of this submission is to indicate to you that when we go to borrow money in the marketplace investors in our bonds take a look at the general economic position of a city or town or municipality that is seeking the funds, and what they bid for our bonds sometimes is reflected in how much we can put out on the market at one time, and that is governed by those factors. We are in the position that if we are not getting the development and

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expansion of the type that they like to see then we do not get the response when we need to borrow capital. It is only in that sense that we can refer to the burden of property taxation before this Commission.

MR. TURPIN: It is true, Mr. Chairman, that the provincial and federal governments are giving us more, but that is mostly due to social legislation which has been passed and adopted by the provincial and federal governments, but at the same time ---

THE CHAIRMAN: And which was enthusiastically supported by the municipalities.

MR. KUSHNER: Could we do otherwise?

MR. TURPIN: Yes, but at the same time, Mr. Chairman, through the winter works programme they are trying to shift on to our shoulders the responsibility for unemployment. We have to borrow winter after winter money to undertake these winter works projects to take care of unemployment. We have done so for the past two years, and we are in it again this year, but we are reaching our limit in this type of undertaking because our borrowing power is so affected that we cannot, I think,continue to do so for many years to come. I am referring specifically, of course, to the City of Hull. We will not be able to continue to carry on. The federal and the provincial governments in our case may be paying 90 per cent of the direct labour cost, but that represents only 13 per cent

They are gradually shifting the responsibility for unemployment on to the municipalities through these winter works projects.

COMMISSIONER BROWN: On this question of municipal revenues, have you any statistics, or have you done any work on getting figures on the change over the years of per capita taxation as paid by individuals as against net incomes after payment of federal taxation by individuals?

MR. MOONEY: We have done no specific work on this matter.

COMMISSIONER BROWN: This sort of thing would back up your argument a little more.

MR. MOONEY: What we have been saying here is that with respect to this major source of revenue, upon which municipalities depend for their operations, namely, a property taxation, we have been saying that property is now being taxed very high, generally speaking, across the country. We have not said that our cities and towns are impoverished, because there is a great concentration of wealth in most of our cities and towns, and in particular in our larger cities. We are saying, however, that municipal governments are not in position to get at the taxable wealth of their communities because it is largely pre-empted already by the federal government and by the provincial governments.

Mr. Chairman, you have raised the question that if the property taxation is not adequate, then what other taxation do we suggest? The

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Federation as such has no position on that matter, but the subject has been discussed informally and there is a growing view -- I think I express it correctly when I say there must be a greater dependence on income taxation, and that this is a fair taxation. There was a time when municipal governments were in the income tax field in a modest way prior to the war in the City of Montreal, in Moncton, and in Saint John's, New Brunswick. These three municipalities participated in income taxation. You are all familiar with the war time taxation agreement whereby the municipalities agreed to take their municipalities out of the income tax field and since then municipalities have not been in that field.

Many American cities are in that field, and there is a feeling, particularly with reference to school taxes which today are a burden on the property tax, that if lower property taxes could be levied so that revenue for schools be derived from other than property taxes, for instance, income taxes, that would give municipal governments the further expansion in taxation revenues that they need.

It was suggested by the Gordon Commission that a possible source of added municipal revenue was taxation on automobiles. There is a great variety in the taxation on automobiles from province to province across the country, and I suppose that automobile owners in many provinces -- I suppose in all provinces -- regard the taxes that they pay on their automobiles as high, but even if those taxes

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were doubled they would not give the necessary relief, and in terms of local municipal taxation, a tax imposed on automobiles would not give the municipalities any great leeway in the need for further revenues that they require.

We have no view, Mr. Chairman, as to the possible source, but in general our municipal thinking is broadly along the direction I have indicated.

MR. TURPIN: Mr. Chairman, fifty years ago perhaps property tax was a fair tax because then most wealth was represented by real estate, but today it is represented in common shares and bonds and an imbalance has taken place in the basis of taxation. I do not think the real estate tax for schools is fair any longer to all Canadians in general because a lot of people now have wealth represented in stocks or in bonds and they are not taxed as fairly as others.

COMMISSIONER BROWN: You are getting a little wide on that point because people own shares in a company, and the company owns property and the municipalities are taxing that property and it all comes to the same thing.

MR. MOONEY: It all comes to the same thing but not in the same place.

COMMISSIONER BROWN: But it balances out all over.

MR. KUSHNER: Yes, as has been pointed out, using statistics is dangerous. Statistics remind me of a fellow who drowned in a river the average depth

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of which was less than one foot, but he found a deep hole in it. There are many municipalities now in a deep hole and we cannot generalize.

COMMISSIONER BROWN: It was the generalization that I was taking issue with.

MR. LLOYD: That is the reason why I was very careful about generalizations. I can never understand why it is in Canada in 1962 that the Canadian National Railways pay full real property taxes in the City of Montreal on its properties there. They pay what is called a water tax, which in essence is a business occupancy tax, in the City of Montreal and they also pay tax on their hotel, but in the Maritime provinces, by some legal fiction dug out of the writing of the British North America Act they are still only paying on half of the property tax, and this has been argued for some twenty years.

If governments were paying their share of taxation on their property equally right across the country, which is not the case, then when they started to build other new things they would say, "Look, we have a tax factor down here or over there or somewhere else, and we have to meet it. We had better be very careful about our political expediency decisions, about what we are going to build because we will have to work out our revenues on a basis sufficient to meet our taxation payments." That is very important to Canada as a whole and there are many illustrations of contradictions in that area.

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COMMISSIONER BROWN: You are bringing up a

new point which has some validity, that is the question of whether or not government authorities contribute to the tax roll on the basis of the properties they own in municipalities, and this has not been mentioned this morning.

MR. LLOYD: I think the Federation has worked very hard in this field, and we now have the Municipal Grants Act which applies to post offices, and defence installations, and things like that, but there is still the National Harbours Board and the Canadian National Railways which are outside this sort of thing.

COMMISSIONER LEMAN: There is one thing in your brief which comes out quite clearly, that instead of proposing raising taxes you are proposing various ways of reducing costs. This is a commendable approach.

MR. KUSHNER: On that point, Commissioner Leman ---

MR. LLOYD: May I just say this before you go on, Mayor Kushner, may I get this one point clear that real property as a measure of fair and equitable contribution to municipal needs has its limitations. This has the result that the more you put on it the greater are the inequalities. You have to be extremely careful how far you go with municipal taxes and this is the reason, as Mr. Mooney emphasized, that gradually the governments policy is shifting over certain costs to the income tax field and the sales tax field. We say that this

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process should continue, but gradually as the affairs of the nation permit it. This gradual shift of those things which will benefit the whole of Canada, and education is certainly one, will help in the taxation structure, and I certainly am not going into the traditional story about Nova Scotia exporting brains, but we have to pay the cost of education anyway.

MR. KUSHNER: In line with what Commissioner Leman said regarding this point about reducing costs, it is all right to talk about reducing costs but if we at the municipal levels across the country started cutting costs, which means in effect cutting services, we would shake the economy of the country because we are really the ones which keep it going. The federal winter works program must stem from us.

COMMISSIONER LEMAN: Your general approach is to suggest one way of reducing costs by reducing the costs of the capital used.

MR. KUSHNER: Yes, that is correct.

COMMISSIONER LEMAN: And I say it is very refreshing to hear this talk about cutting costs.

MR. TURPIN: I cannot help but make this point clear again, that property tax is becoming more and more unfair because more and more wealth today is being invested in other types of values. It is not like fifty years ago when it was all in real estate. More and more people are investing in stocks and bonds, and thus they are getting away from paying their fair share of municipal and school taxes in that way. It is true that there would be equalization of

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COMMISSIONER BROWN: There is another side of that particular point, and that is that Canada is one of the countries -- and there are not too many of them -- that permit the owner of real estate which he occupies to omit the income value of that ownership from his income tax return.

MR. MOONEY: No, sir.

COMMISSIONER BROWN: In other words, if you have an investment in a house you do not have to value the income value of that investment for income tax purposes.

MR. TURPIN: If it is for your own occupation.

COMMISSIONER BROWN: Yes, for your own personal occupancy, whereas in other countries this has to be included.

MR. MONGRAIN: But in those countries they also allow the payment for mortgage interest and then it has to be deducted. There is the other side of the coin as well. We are talking in generalities in one way, and it is refreshing to hear it, but it strikes me that we are dealing basically with the same

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taxpayers and there is the question of arriving at the most equitable way of doing so.

Coming back to the main aim of the Commission, we are suggesting to you that so far as we are concerned in the municipal field, one of the ways we feel we can be relieved of having to impose a heavy burden of taxation on real estate is through this medium of borrowing, but there are many cases where municipalities cannot go to the money markets. As a matter of fact the great city of Toronto, metro Toronto, has been told by the Municipal Board to be careful about its borrowings, and they are probably the No. 1 rating in Canada at the moment. You can go right down the line from there, and you have to find some way to enable us to keep going to the money markets.

THE CHAIRMAN: The other way might be to slow down your programs.

MR. MONGRAIN: But if we do that the economy of the country would suffer.

THE CHAIRMAN: But your worry is not what is going to happen to the whole economy; it is what is going to happen to your municipalities.

MR. LLOYD: Finally, Mr. Chairman, this Commission has been appointed because the federal government feels that it should go all out to find out more about these things and see if it can correct abuses and imbalances and mistakes that have occurred.

THE CHAIRMAN: Correct.

MR. LLOYD: We are suggesting to this

taxpayers and there is the question of arriving at the most equitable way of doing so.

Coming back to the main aim of the Commission, we are suggesting to you that so far as we are concerned in the municipal field, one of the ways we feel we can be relieved of having to impose a heavy burden of taxation on real estate is through this medium of borrowing, but there are many cases where municipalities cannot go to the money markets. As a matter of fact the great city of Toronto, metro Toronto, has been told by the Municipal Board to be careful about its borrowings, and they are probably the No. 1 rating in Canada at the moment. You can go right down the line from there, and you have to find some way to enable us to keep going to [illegible]

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THE CHAIRMAN: Correct.

MR. LLOYD: We are suggesting to this

Commission on Banking and Finance that the municipal governments can contribute to the stabilizing of the economy while Canada is trying to adjust itself to international trade changes.

As Mr. Mooney expressed it in other briefs and on other occasions, if we undertake a new project, build a new road or a new bridge in our own municipalities to take care of our populations' growth, we make a solid contribution to keeping the economy moving along, and in order to make that contribution to solving this general problem of common concern to all Canadians we are suggesting that you, on this Commission, can direct your attentions to the plight of the municipalities in finding money for their purposes. We are suggesting to you that you do not load this property taxation unnecessarily with higher rates of borrowing. We are suggesting to you that your interest lies as a Commission in seeing that the municipalities can keep up with their public operations which, as Mr. Mooney in another brief said, are persuasive to the whole economy. If we build a bridge in Halifax, or a road in Halifax, or construct a highway in Halifax,Vancouver, Winnipeg or Toronto, the necessary supplies for those capital undertakings are supplied by the industrial complex of Canada and everybody benefits by these activities. If we fail to do that then we go back to the dreary days when I first entered municipal government, when you borrowed money to pay for your share of direct relief.

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this: that the municipalities are in a position to spend money in a greater variety of ways with a greater impact upon the whole economy.

MR. LLOYD: That is right.

THE CHAIRMAN: With greater social results locally ---

MR. LLOYD: And nationally.

THE CHAIRMAN: -- and nationally than money that is spent through central agencies?

MR. MOONEY: That is relatively so.

THE CHAIRMAN: And that the multiplier effect of that, of money spent on some big project in some specific place will spread throughout the economy.

MR. MONGRAIN: That is correct.

THE CHAIRMAN: And if there is always a demand for more services and need for more services, and even if we are in a time of recession your position is that the best way to solve it or to approach its solution would be to open up the coffers to the municipalities?

MR. LLOYD: Or to remove any possible barrier to the full utilization of this advantage to the economy.

MR. TURPIN: We would like to very much do what you suggest, Mr. Chairman; to slow down our capital expenditures, but we are under pressure. The provincial governments tell us to clean our rivers; the federal government asks us to co-operate with it to alleviate unemployment through winter works programmes; the provincial highway departments ask us to improve our communications between cities and between provinces within our cities. The pressure is so much on us that we have to envisage increasing capital expenditures and certainly not a reduction in them over the next ten to fifteen years.

In our city across the river we have undertaken a sewage treatment plant, a water filtration plant and this will cost between $10 million and $12 over the next three or four years. Certainly we cannot put any greater burden on our property owners due to these capital expenditures.

THE CHAIRMAN: We shall now adjourn for 15 minutes.

--- Short recess.

THE CHAIRMAN: We will now resume.

COMMISSIONER BROWN: Gentlemen, we got off on a bit of a tangent just before we broke, and I think it was largely my fault. Perhaps we might now bring this back more to what we are really discussing, and that is the problem of your financing.

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minutes the question of your short-term financing which is largely for two purposes; one, for current needs pending tax collections, or pending receipt of grants from higher authority and; the other one, pending long-term financing.

In respect of your bank financing, or short-term financing pending tax collections or receipts of grants, you make the plea that you are a prime creditor and, therefore, you should get consideration from the banks.

MR. MOONEY: Prime consideration.

COMMISSIONER BROWN: This whole thing brings up the question of the 6 per cent ceiling on bank interest rates. Have you had any thoughts or discussions as to an opinion in respect of this 6 per cent ceiling? Do you think that if the banks had wider range in respect of their charges that they could perhaps have lower charges for the prime borrowers and higher charges for the other borrowers, or have you an opinion on that?

MR. MOONEY: I think there are opinions on this rather than an opinion. Mr. Lowther, who is the Commissioner of Finance for the City of Ottawa, would be the one who deals realistically with this problem. Perhaps Mr. Lowther might like to make a comment.

MR. LOWTHER: Well, Mr. Chairman and gentlemen, I do not see in one sense why the level of interest rates chargeable by banks might not conceivably find its level on the basis of the general

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market or credit position as the case may be in the same manner as other lenders of money are able to adjust the rates of interest that they are prepared to allow in provinding credit.

I think, if I may express it this way, the one fear that municipalities might have if the ceiling on bank rates was raised, is that most if not all of us might find ourselves at the higher rate rather than at the restricted rate of 6 per cent as it is now. There have been only few cases, at least as far as I can recall in recent years when the bank interest rates were down below I believe 5 per cent, when there was any special consideration given to the rates charged to municipalities. I believe there is a relatively small so-called select group of municipalities which were given a favourable rate as compared with municipalities generally, and at that time there was also a differential accorded to municipalities depending on whether they financed by overdraft or whether they financed by note. That differential was a quarter of one per cent, in our case at least. I do not know whether this same differential applied to other creditors.

When interest rates went up to the level of $5\frac{1}{2}$ per cent, if my memory serves me correctly, that benefit as between overdraft and demand note financing disappeared and, of course, when it went up higher, to $5\frac{3}{4}$ and 6 per cent, where it is now, the special considerations to this more or less

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select group of municipalities disappeared.

I think it is within the context of that range of argument, so to speak, that we might have some apprehension over the raising of the bank rate as to whether or not this would prove of the kind of benefit for municipalities that one might expect. There would always be, I would suggest, probably differences of opinion as to what constituted a prime creditor on the part of municipal governments. Everybody would think they should have the best credit rating.

COMMISSIONER BROWN: This does not apply just to municipalities.

MR. LOWTHER: That is right, and I am not so sure from that standpoint whether this would have, in its practical result, any beneficial effect as far as municipal borrowers are concerned.

MR. MOONEY: The 6 per cent prime rate has been a factor, of course, in the trend that has developed in the last relatively short while for municipalities, and they have acquired their short-term requirements outside of the banking structure, through their own other means. This is referred to, as you know, in our own submission, paragraph (g) at page I-2.

COMMISSIONER BROWN: Yes, and you mentioned the experience of Winnipeg. I wondered if you have any statistics as to how many municipalities did that this year and what the total borrowing was, as well as what the advantage

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COMMISSIONER BROWN: Yes, and you mentioned the experience of Winnipeg. I wondered if you have any statistics as to how many municipalities did that this year and what the total borrowing was, as well as what the advantage

was? Have you any figures?

MR. MOONEY: We have no complete statistics, but there is an addendum at that page at the bottom wherein we point out that in the spring of 1962 there was a number of municipal issues of municipal paper sold privately and at a discount, bearing coupons of 2¼ per cent maturing in two to four months, costing the municipalities some 2.83 per cent to 3.65 per cent.

COMMISSIONER BROWN: You have not any figures in respect of the total involved?

MR. MOONEY: I have not the figures in respect of the total.

MR. FULLERTON: It should also be considered that the maximum outstanding at any time is around $75 million. That is by way of a gossipy estimate in that these were practically all private placements and not made public.

COMMISSIONER BROWN: You do not mention one other expedient that a number of municipalities use, and that is the discount for pre-payment of taxes.

MR. MONGRAIN: This is being done in a few cities.

COMMISSIONER BROWN: And you do not mention the other possibility, and that is having taxes collected on a monthly basis.

MR. KUSHNER: Some provinces will not permit it.

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COMMISSIONER BROWN: Has this been

discussed at all?

MR. MOONEY: Yes, it has been discussed and continues to be discussed. There is no general trend developing as to whether, or what a municipality is likely to do, but I think increasingly municipalities are likely to go off the annual and semi-annual payment to a quarterly or even monthly method. Some municipalities I understand are on a monthly payment basis now.

COMMISSIONER BROWN: This would reduce borrowing?

MR. MOONEY: Yes.

COMMISSIONER BROWN: And would also reduce the investing end of it for the second half of the year, is that correct?

MR. LOWTHER: But it will also cost more money.

COMMISSIONER BROWN: That is right.

MR. LOWTHER: I think generally speaking it can be said that the monthly or bi-monthly system of paying taxes would prove more costly in the long run because of greater administrative costs. This is so in our case. We made a study of it and we decided that this could be justified only on one basis, and that is, shall I say, lessening the resistance of the taxpayer toward increases in taxes.

COMMISSIONER BROWN: That might be a good reason for it.

MR. KUSHNER: Incidentally, you are referring

to the assessment of taxes. I think we have noticed that in those suburban areas that have grown up in the last few years surrounding each major city, the discounts are taken advantage of -- because there are only perhaps half a dozen companies which pay the total taxes -- by a very few, whereas in a city itself most of the homes are owner-owned and mortgage-free, and in these cases the discounts do not apply to the same extent. We can almost assume that when these areas reach the stage where these companies get off the hook, and the individual will own his own home, they will be in exactly the same position as the cities are now.

MR. TURPIN: I can give you a case in respect of our own city. We gave a 3 per cent discount for pre-payment of taxes in the first month after the bills are sent out. We discontinued that last year because we found that there were four or five large taxpayers who were getting about one-third of the total discount. We have changed over to a system of charging 5 per cent interest after two months from the date of sending out of the bills. We think we are saving money and making taxes a little more equitable because only four or five were taking advantage of the discount, representing about one-third of the over-all discount given, and about 50 per cent of all property taxpayers. The load was not evenly distributed.

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MR. KUSHNER: A situation has developed in some of the provinces because provincial legislation

limits the penalty in respect of arrears of taxes to one-half of one per cent per month. We have literally hundreds and hundreds of cases, particularly in areas where the entrepreneur, as Mr. Lowther likes to call them, but I call them speculators, own thousands of acres of land and deliberately let the land go into tax sale for two years, and we have to finance them, actually, because provincial legislature prohibits us from charging more than one-half of one per cent, although we have asked for this to be increased. Indirectly we have to finance them as well.

COMMISSIONER BROWN: In respect of the matter of short-term financing pending capital issues, to what extent does this act as an insulation against higher interest rates in the long-term financing end of it? In other words, to what extent does this improvement in the availability of bank credit give you the opportunity to delay long-term financing until interest rates are more favourable?

MR. LOWTHER: Well, I think the only way that this can act in that manner which you suggest is that it gives a period of time within which to exercise a decision. There is a variation in the practice. For instance, some municipalities -- probably less frequently now than they used to in the past -- quite frequently issued their bonds before they did their work. Now the tendency is the reverse. You borrow from the bank to finance your programme and when the work is finished you go

on the market.

To the extent that you are able to get short-term credit in the manner that you suggest, as I said a moment ago, this gives you a period of time in which to exercise some judgment as to when you should try and sell the bonds for the particular purpose you have in mind. Beyond that, other than from the standpoint that I do not think municipalities generally speaking should be in a position where they have to try and play the market, the general philosophy which seems to commend itself to me, at least, is that when you need the money you go on the market for it and you pay whatever the price happens to be. If you try to hedge against a raising or falling market you can be caught off base and can be wrong. If you are right you are a hero, but if you are wrong you are not a very good finance commissioner.

COMMISSIONER BROWN: Ithink that is the point I was trying to bring out. This bank financing in respect of long-term borrowing is done at your option?

MR. MOONEY: Generally.

MR. DAWSON: Not entirely. I would question that. In Montreal we just had a $29 million issue for the Metropolitan Area. We delayed that issue for almost a year because the provincial government had other issues. The Hydro had an issue of $50 million. This became a provincially guaranteed issue and they said: We do not want you going on

the market now. In the meantime we used bank credit. So, I think it is a question of supply in the money market, and this has some bearing as to when you are going on the money market.

I quite agree with Mr. Lowther, I think we as municipalities should try to be smart every time, but there is that other factor in respect of large issues such as we have in the Metropolitan Corporation, we have to delay because of other issues.

MR. LOWTHER: I suggest as well, gentlemen, that a municipality has not complete flexibility in the exercise of its judgment in respect of the short-term credit situation. The position of the banks themselves sometimes promotes this situation, to be quite frank. I say this with some hesitation because of one member of your Commission who is sitting in front of me, but I think our banker was quite happy to see us go on the short-term market this year in respect of $10 million.

MR. TURPIN: The option to exercise our judgment in that field is limited, at least in our province. The municipal commission tells us when we should or should not go on the market with an issue. I think this is good because it limits the number of municipalities coming on the market at a certain time. We have found that the advice of the municipal commission in the province of Quebec has been extremely helpful in that field.

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to the number you can use because you are up against this attitude of the municipal commissioners. We are responsible to the provincial governments, and they are watching to see that we do not go too long without meeting our obligations in retiring capital borrowing.

MR. TURPIN: If it was possible to find a means of perhaps averaging the interest charges to municipalities when they have to go and borrow for two or three months in comparision to what they receive when they invest funds that they have in surplus, I think it would be very helpful. In our own municipality as of the first of June, or the fifteenth, we have $1 million surplus. We invest it in short-term Treasury Bills and get perhaps four, four and one-quarter or four and one-half per cent. When we have to borrow we have to pay a higher rate of interest. If it were possible to use one municipality's surplus to finance municipalities which had to borrow on short-term the over-all result would be a lower rate for all municipalities in Canada.

COMMISSIONER BROWN: You are suggesting that municipalities should work on different year ends? Are they not all on the same seasonal basis?

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COMMISSIONER BROWN: You make mention of a government sponsored loan corporation, but it seems to me that this is something which municipalities within each province must work out with their own provincial legislatures, if it is feasible at all.

MR. KUSHNER: No, sir, Mr. Commissioner.

COMMISSIONER BROWN: I am not talking about a national loan now at all, I am talking about short-term. I am not talking about long-term borrowing, I am talking about short-term borrowing. At the moment you probably are all trying to borrow in the spring and invest in the fall, and when I say "all", again I am getting into a generalization?

MR. MOONEY: That is correct, generally.

COMMISSIONER BROWN: It would only be possible to do it among yourselves if you had different year endings; some of you collecting your taxes in January and others in October, etc., otherwise it is not feasible, is that right?

MR. KUSHNER: Right.

COMMISSIONER BROWN: Could we now go on to long-term financing? You make quite a lot of the statutory limitations based on assessed values, and you mention the commission report of the United States. To what extent are there in fact statutory limitations?

MR. MOONEY: Right across the country.

MR. KUSHNER: Right across the board.

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MR. MOONEY: [illegible]

MR. [illegible]: [illegible]

COMMISSIONER BROWN: Is it not correct that in most provinces these statutory limitations are relative or in relation to assessed values when you are borrowing for general purposes?

MR. LLOYD: There is none in the city of Halifax.

COMMISSIONER BROWN: The City of Halifax is subject to no limitation?

MR. LLOYD: There is no limitation as to the amount of an issue. This is based on the judgment and decision of the Mhnicipal Affairs Board; in the first instance, the City Council.

COMMISSIONER BROWN: You have no statutory limit?

MR. LLOYD: There is no statutory limit on the amount we can borrow.

MR. LOWTHER: We do not have in Ontario either.

MR. KUSHNER: We have in Manitoba except in respect of the City of Winnipeg which has its own charter.

MR. DAWSON: Quebec has.

COMMISSIONER BROWN: I know there are in some cases statutory limits on borrowing for some purposes, but public utility borrowing is exempted from this?

MR. DAWSON: Not in Quebec.

COMMISSIONER BROWN: In Quebec it is under statutory limitation?

MR. TURPIN: It is 20 per cent.

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MR. [illegible]: It is 20 per cent.

COMMISSIONER BROWN: Presumably to borrow implies ability to repay and a willingness to repay. Do you suggest there should be no limitation on this at all?

MR. MOONEY: No, we are not suggesting there should be no limiation. We are suggesting, however, that the present rule of thumb consideration that the market seems to bring to bear on municipal borrowings needs re-examination, and we are suggesting that where there exists provincial statutory limitations, they should be looked at again and, even in those provinces where there happen to be no provincial statutory limitations but where in effect there are limitations exercised, that the basis upon which municipal governments are able to borrow in a particular amount should be revalued.

We have summarized the general point of view and the general conclusions of the Inter-Governmental Committee in the United States as indicative of the sort of inquiry that ought to be made with reference to Canadian municipal borrowings so far as limitations are concerned.

COMMISSIONER BROWN: Surely you have some criteria to suggest, have you not?

MR. MOONEY: We have no precise criteria. There are some municipal people who feel that the limit on municipal borrowing ought to be related more to the proven revenue resources of an individual government, and probably a projection of the potential revenue over a period of five to ten years to come or

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during the lifetime of the borrowing. The idea is that this is a more valid basis for computing the capacity of the borrower to pay than merely the assessment value of the property in the community.

MR. KUSHNER: Generally speaking, Mr. Commissioner, all things being equal, assuming the economy does not go down too much, why should there be a different yardstick applied to the municipal borrower than is applied to the private borrower? Why should not a similar yardstick, the capacity and resources and ability of the borrower to repay, be used both for municipal borrowers and private borrowers? And why should there be an arbitrary ceiling of 20 per cent, and that is it? There does not seem to be any rationalization to that percentage. Surely just a flat 20 per cent ceiling without any reasoning behind it does not make sense.

COMMISSIONER BROWN: Have you any statistics on how many mumicipalities are up to this ceiling?

MR. MOONEY: No, we have no actual statistics. They are not available.

COMMISSIONER BROWN: You must be able to tell us how many larger cities are up to it?

MR. KUSHNER: The larger cities all work within their own charters. As I mentioned, the City of Winnipeg, Manitoba, under its own charter has no ceiling.

MR. LLOYD: There is no statutory ceiling but we have a limitation imposed. They just will not

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approve a bond issue in the City of Halifax, in the Province of Nova Scotia, if it exceeds a 20-year period. Lacking the criteria and the kind of knowledge on matters about which this Commission is trying to enlighten the government, this is the search: Can we have more sophistication in this matter and instead of just saying, "We don't know what the answer is and, to be on the safe side, we will say twenty years"?

In a sort of elementary way they say: look at the interest it is going to cost you. Yet, in many cases, if you did not pay the interest you would not have the services or extended facilities in your time. If someone wants to come up with some scheme in the province, saying, "Look, we want you to pay as you go along" then we would have to bow to that policy and would have to find some ways and means of putting it beyond our present obligations and on a pay-as-you-go basis.

All we are saying is that in looking ahead to the kind of things we have to do, if there are going to be limitations they should be related more to the particular kind of projects being undertaken. For example, if you are going to share the cost of land acquisition with the federal government, which is done at the present time on a clearance scheme under Central Mortgage and Housing Corporation, the federal government puts up 50 per cent of the revenue and the local municipality puts up the other 50 per cent. You have to fund this operation.

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In the old country I believe there is a device known as debenture stock. We had debenture stock years ago, and all we paid was the interest and it had no terminal date at all. In fact, some of it is still outstanding, but not very much. We have pretty well taken care of all that. But in the case of land which has a development value in it, it may very well be that the carrying charges would serve as a debenture. This is something we do not know. In the case of financing water utilities, you come up against certain conflicts. In the case of a publicly-owned utility in Nova Scotia, the Board's regulations with respect to accounting for depreciation are all oriented to the private company with equity capital, when the needs to maintain the shareholders' capital fund is obvious. Yet, under these regulations the limit of a water utility is 30 years, and you have a water system main supplied for a life of 50 to 60 years or more, and with respect to your capital installation for your reservoir, your water source, the tendency is to attempt, first, to require the municipality to retire the capital, repay the capital over thirty years and secondly, at the same time, in the rate structure to provide for depreciation of the asset and have the current generation provide the capital not only for the current plant but also for the replacement. This is an illustration of what is happening in Nova Scotia. It is only one illustration and it may be an isolated one in Canada. I do not know this, but I do think if the Municipal

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Affairs Department would distinguish between revenue-producing projects, as Mr. Mooney has point out, and those kind of capital works that obviously have a rural life, generating revenues, if you like, or even generating tax revenues, that some longer periods might be practicable in certain circumstances.

MR. MOONEY: May I just make this further observation, that while there are to our knowledge no statistics as to the percentage of municipalities whose debt is verging on 20 per cent of their tax value, it is generally said among municipal people and in meeting in conference together that there is a growing number of municipalies that are marginal to that position. It has been said that there are some who are over it. I stand to be corrected but I am of the impression that the City of Toronto, or Metropolitan Toronto, is marginal or over that position. I understand that the City of Ottawa is marginal or over that position. I believe that other cities across the country are getting up to the marginal point, so that their capacity to undertake any very substantial, net capital commitments is increasingly being limited.

MR. MONGRAIN: Mr. Chairman, I should like to be allowed to say a few words in French then I would ask my friend George Turpin to translate what I say. I can explain myself better in French.

(As translated by Mr. Turpin): We are discussing the means of raising money, and especially long-term requirements. Financing municipal

capital expenditures is very different from financing the capital expenditures of a private enterprise. A basic and fundamental new means must be found to raise the money to finance these capital expenditures. We are suggesting very respectfully to the federal government that it is urgent to find ways and means of perhaps doing this through the method used in Europe, like the Belgium "Credit Communal" and others. If the Federal government could find a means of creating an institution that would have branches in the provinces, or would work with the provinces to help the financing of municipal capital expenditures, I think most of our municipal financing problems would thus be taken care of, if not eliminated. At least it would settle probably 85 per cent of all our problems. This seems to be the opinion of a good number of my colleagues, if not the majority of them.

COMMISSIONER BROWN: I had some other points to discuss on the present situation, but as this point has been brought up perhaps we might consider it now. I understand that Mr. Leman has some questions on it.

COMMISSIONER LEMAN: Well, the means that Mr. Mongrain is now referring to is what you suggest in your brief, "A national municipal loan fund". There are some aspects of the proposal, though, that were not too clear to me. In Appendix "A" you did give us a little bit of information about these types of institutions that you say have been created

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in other countries. I could not find one that was exactly quite the duplicate of what you seem to be suggesting here.

MR. MOONEY: We are seeking to establish, Mr. Leman, by the appendix that the principle and the idea of a national institution to provide the capital required by municipal governments is not a new idea, that this is something that has been done in a great number of countries in Europe. We have placed in the appendix the general operation, the modus operandi of these particular national institutions in these various European countries. But we are not thereby suggesting that any one of these is the pattern for what we think is needed in Canada, but merely to overcome the objection that may be raised, "Well, this is a new and novel idea. Is it practical?" I can say that it is practical in those countries that we have illustrated.

COMMISSIONER LEMAN: All right, but I would like to ask you a few questions on this. I will start with some general questions and then we will get down to some more particular questions about it. First of all, was it because you felt that it was of the resort of this Commission to discuss or investigate what this could do for municipalities in the form of reducing costs of raising capital, that you restricted the discussion to this point? It seems to me that it would not solve all your capital raising problems --

MR. MONGRAIN: Most of them.

COMMISSIONER LEMAN: -- to achieve this idea of getting a formation of such a body on a national basis. I have not got the reference here exactly but what do you think on average this would accomplish in the sense of reducing your average cost of capital used, in, say, percentage? How much do you think it would do?

MR. MOONEY: We think it could reduce percentagewise the cost of borrowing problably by one and a half per cent.

COMMISSIONER LEMAN: One and a half per cent of average cost?

MR. MOONEY: This is in terms of our basic proposals, and that is that the federal revenues derived from taxation of interest on municipal bonds be applied to municipal loans contracted through the muncipal development loan agency that we suggest in our brief.

COMMISSIONER LEMAN: How much do you think that would produce a year?

MR. MOONEY: We think probably something in the range of $50 million to $60 million.

COMMISSIONER LEMAN: You have that reference in paragraph (e) on pages Q-1 and Q-2, but you do not give us any figures on how much you think that would produce by way of income. The point is this. Suppose you did reduce the average cost of borrowings for municipalities by one and a half per cent. In an earlier section you indicate the huge size of future capital requirements of

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municipalities and it does not quite convince me that unless there is some kind of a re-allocation of responsibility between municipalities and senior governments, that you would quite achieve your purpose. It might help.

MR. MOONEY: We go further. We have not done it in this statement, Mr. Leman, but we have been arguing the proposition with the federal government, and we will be returning to the argument in a meeting that we have with the federal cabinet on November 9th, namely that there is a parallel interest today in many of the possible works undertakings, a paralld interest between the municipal, provincial and federal governments.

We are contending that the growth and redevelopment needs of cities these days are no longer purely local, that they are part and pracel of a national situation and that therefore there is a strong and compelling case for a greater participation by the three levels of government in the implementation of these capital works requirements. Therefore, we contend there is greater need for federal and provincial participation in the capital costs of many municipal undertakings, and that if this were done, if the borrowing cost to municipal governments of their share of expenditures in these undertakings was made available to them at lower carrying costs than they are now, we could see these undertakings being carried through.

COMMISSIONER LEMAN: All right. Let us

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get down to exactly what the concept is. First of all, why do you believe this has to be undertaken at a federal level?

MR. MOONEY: For several reasons. Perhaps others might want to add one or two reasons, but we think the time has come when we have to not only say we are a nation but we ought to act as a nation, and we say that these are national concepts that we are putting forth.

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We don't think the ten provinces are equally able to undertake these responsibilities that we are suggesting. It may well be that the larger and wealthier provinces could fully undertake the responsibilities, jointly as between provincial and municipal, including the raising of capital funds, but we don't think that this would be true of all the ten provinces and therefore we suggest that it should be done nationally through the Federal Government initiating in co-operation with the provinces the instrumentation whereby all provinces and all municipalities and all companies have an equality of opportunity to participate in this undertaking. That is one basic reason.

Secondly, we believe that on balance we would get a better rate for municipal governments with the Federal Government creating the loan fund and backing it with its credit, as against the variation that there may be if it were done on purely a provincial level, and therefore we get a better ---

COMMISSIONER LEMAN: Is it your concept that the Federal Government would guarantee all borrowings by this fund?

MR. MOONEY: Our concept is that it would be a joint guarantee of the province and the Federal Government and the borrowing municipality. You are bringing to bear on the capital needs of municipal governments these supports, and that is our concept.

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Now, there is ample precedent for what we are proposing right here in the Canadian situation. The Municipal Improvement Self Liquidating Loans Act of 1938 is in substance what we are suggesting should be re-instituted, but on a different basis than the national Municipal Improvement Self Liquidating Loans Act of 1938. The legislation which permits the Central Mortgage and Housing Corporation to make loans to municipal governments with approval is of the same general nature as what we are proposing, and for the same purpose.

We don't think either of these approaches is sufficiently comprehensive for our needs, looking to the future.

MR. TURPIN: What has been done also for industries through the Industrial Development Bank; I think this is a definite example of what the Federal Government has done to help industries. Why couldn't the same thing be done to help the municipalities? It was done by the Federal Government.

COMMISSIONER LEMAN: You point out that you feel that municipalities should remain free to borrow through this instrumentality or to go outside?

MR. MOONEY: That is right.

COMMISSIONER LEMAN: Now, would you visualize that if there existed such an institution the municipalities should still remain under some control as to how much of these funds would be

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available to each municipality?

MR. MOONEY: We would think ---

MR. KUSHNER: On that point we are not saying how it should control them; we are suggesting that the Federal Government -- say that it will support X dollars -- we envisage a practice wherein that application would be processed by the provincial authorities as to the amount and the qualifications of the municipality, and that after approval we probably would get the funds from the Federal Government.

MR. MONGRAIN: We would still have to go through our municipal commissions who have set the standard.

MR. LLOYD: There is another very challenging aspect to this matter which would involve you as a Commission to a greater degree than has been expressed in this brief.

Canada's position with regard to need for capital for all of these purposes, private and government, puts us in a position that we have to go abroad to find that capital, and the extent to which we obtain it, and later on there is the residue of problems affecting the exchange rates. One part of the country finds that for some reason or other it cannot finance as easily in the American market, for example, as another part. Somebody mentioned today the fact of $29 million being arranged, and most of it all in the United States. The residual impact of this kind of shift to borrowing

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extensively in the United States I would imagine would be of some concern to this Commission and its ultimate recommendations, although I am not knowledgeable enough to know what trend it might bring about, but it would seem to me that in our borrowings abroad for municipal purposes if we took the Canadian approach to it rather than leaving it to the individual that this would be desirable from a national point of view because of its ultimate effect in future times of having to meet the repayments in foreign currencies, and it would seem to me that acting in concert through a national agency would be desirable from a national viewpoint.

Now, it has been said on occasions that Canada does not own enough of this equity interest in its industrial and other production. I don't know whether this kind of thing would shift the amount of borrowing we do from equity to capital coming into Canada to a greater degree of bonded indebtedness or not, and all which that implies, but certainly I think it is food for thought that we might very well, if you have got to go outside for capital, we might be able in the end result, through taxation and other policies, we might be able to get more of our capital needs supplied to Canada in terms of borrowed money, interest paying borrowed money, than in terms of equity controlling capital. I don't know. I don't know enough about the total operations in Canada and

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what stimulates private enterprise to get into things, and it would seem to me that there is concern of the national government -- and it has been expressed at times -- about the foreign ownership of Canadian industry, and that there would also be concern about the amount of borrowing each municipality is doing in the United States.

COMMISSIONER GIBSON: Would you say it is a national fund for borrowing in the United States for the benefit of the municipalities?

MR. LLOYD: I would say it is a national fund, and certainly if an institution of this kind was operating it would be extremely useful in guiding and directing the footsteps of the municipalities in its foreign borrowings.

COMMISSIONER GIBSON: Making decisions or giving advice?

MR. LLOYD: Giving advice in this field. There are some municipalities that are better than others and there are others that are not as knowledgeable about what is happening.

THE CHAIRMAN: I understood that the national fund would borrow money directly?

MR. LLOYD: That is right.

THE CHAIRMAN: And the fund would decide whether for the purposes of the fund it should be borrowed in the States or here?

MR. LLOYD: Yes.

THE CHAIRMAN: The municipalities have nothing to do with this decision at all?

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MR. LLOYD: But what are they doing now? The municipalities are borrowing in the States. I am trying to resolve your interest in this from the national viewpoint.

THE CHAIRMAN: I understand your point to be that some municipalities are borrowing indiscriminately in the United States even though that might be contrary to national policy at the time?

MR. LLOYD: That is right.

MR. TURPIN: You have the recent example of the City of Quebec that has borrowed from Switzerland at $4\frac{1}{4}$ or $4\frac{1}{2}$ per cent. I think that this might have been contrary to the national policy.

MR. KUSHNER: As a matter of fact, not very long ago the Federal Government advised that municipalities are not to go to the American market, and then shortly after that the opposite advice was given, but shortly after that there was the devaluation of our dollar and those municipalities that borrowed were caught short. In order to avoid these things and in the national interest we feel that a bank that would grow year by year and by the accumulation of funds through income taxes payable on municipal bonds that it would reach a state where we could do the total borrowing for municipalities right here in Canada, and it would appear to be in the national interest to do so.

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MR. KUSHNER: As a matter of fact, not very long ago the Federal Government advised that municipalities are not to go to the American market, and then shortly after that the opposite advice was given, but shortly after that there was the devaluation of our dollar and those municipalities that borrowed were caught short. In order to avoid these things and in the national interest we feel that a bank that would grow year by year and by the accumulation of funds through income taxes payable on municipal bonds that it would reach a state where we could do the total borrowing for municipalities right here in Canada, and it would appear to be in the national interest to

COMMISSIONER LEMAN: You do suggest that each municipality should remain free to borrow outside?

MR. TURPIN: That is right.

COMMISSIONER LEMAN: But the question I would like to ask you, and I am not sure whether Mayor Lloyd was making this point or not, but if from the point of view of policy there has been some worry about foreign ownership of industry in Canada -- and there have been people before this Commission who have suggested that if we are going to use foreign funds to a large extent, maybe it would be safer to use them for municipal and housing purposes than to use them for industry purposes; what do you think of that?

MR. LLOYD: I suggest to you that it would seem to me a sensible sort of thing; one of those elementary things that crops up, and we say it does make sense. Can anybody tell me what is wrong with the proposition? If you must obtain capital you must, and if you can influence foreign industry to take it in the form of indebtedness, in the form of interest paying instruments rather than in common stock equities, which leads them into management decisions and the operation of the company with the use of natural resources and our skills in this country, isn't that desirable, and to do it effectively shouldn't it be done nationally rather than by looking to the vagueness of the whole range of decisions across the country,

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which may be the end result. It might be the end result is not too much differen..., I don't know, but I would suspect that the Federal Government would see the mutual advantage in the establishment of a municipal bank in so far as foreign capital borrowings are concerned. It would bring them closer to the situation in the long range and the impact of Canada's ability to meet these obligations to foreign countries.

MR. MOONEY: That to the extent that the aggregate of municipal capital borrowing in Canada, which in a given year runs up to $250 million to $300 million, and this has been a recent average, that amount of capital borrowing can have a very significant relationship to national policy.

Now, it seems to us that this can best be exercised through one organization that is in a better position than municipal government to determine whether it is wise, prudent, or thus and so. It takes away from the municipal government probably its right to exercise its freedom in connection with the market, but viewed in terms of the total impact of municipal borrowing, maybe it is a desirable thing to have take place.

COMMISSIONER LEMAN: What I wanted to make sure of is whether you realized that such a body would necessarily result in some kind of allocation of funds in the process in the province?

MR. MOONEY: Right.

MR. KUSHNER: The experience will teach

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MR. LOWTHER: If I may make an observation here, one of the dominant factors which has led or generated a great deal of thinking -- of the desirability of having some such an instrument as that suggested-- has been the fact that as matters stand now municipalities have to establish their position in the market at any given point of time, and that market was influenced by many things over which the municipalities have no control, nor can they do much within their own framework to affect these market conditions in any given point of time.

I think, too, that municipalities are in the position where they are able to withdraw from the market, but they are not able to stop their programme of works at any given point of time to avoid exposing themselves to adverse market conditions, and many of the projects and requirements that they have to finance are generated or precipitated

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Now, what is the result of this? Back in 1956 and 1957 I think there were times in those years when some municipalities in the smaller level -- if I may express it that way -- were unable to find some of the capital that they wanted on the open market. There were just no bidders. Other municipalities, of which we were one, were told by the investment people that true we could get the amount of money we wanted on the Canadian market at that time, but to do so we would virtually have broken the municipal bond market. In other words, we would have had to pay a rate of interest in excess of what normally we might have had to pay had there been a more abundant supply of funds available for municipal investment. The result of this was that we, like other municipalities, then resorted to the American market.

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municipal loan fund is largely from the standpoint of being able to find a source for borrowing money when you need it and when you want it , and that this is probably the dominant factor in this whole thing because, as I said earlier, we are forced to sort of expose ourselves to whatever set of conditions happen to exist at a given point of time through the normal open money market operations, and there is nothing we can do to cope with it, so we just have to accept this as a fact and do the best we can.

COMMISSIONER GIBSON: Did I understand Mr. Kushner to say that this organization would control municipal borrowing?

MR. KUSHNER: Oh no, that wasn't the intention.

COMMISSIONER GIBSON: Municipalities would still be free to borrow on their own?

MR. MOONEY: Oh yes. This organization would marshall the funds; it would obtain the funds.

COMMISSIONER GIBSON You said something about the control of the borrowing.

MR. KUSHNER: There is a certain control which exists now at the provincial level by various municipal bodies, but I am not suggesting that that should be disturbed and the municipality must still go through the process of being cleared by the provincial authority. This wouldn't be an instrument of control.

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MR. TURPIN: No, sir.

MR. LLOYD: It is in the international interests of marketing.

MR. TURPIN: If what has been said so far is true -- and I think it is true -- as to the difficulties experienced by municipalities during the past fifteen years since the end of the war, what can we expect over the next fifteen or twenty years if $29 billion of capital expenditures is necessary to meet the situation? I think it might well create havoc, perhaps anarchy, on a national scale and in international conditions in the financial and monetary fields. We feel it is becoming imperative that such a thing be done, otherwise the provincial and the federal governments will be in difficulties also regarding financial affairs. We will all be seeking money from the same people.

MR. LLOYD: Canada cannot compete, Mr. Chairman, with countries of the common market and other countries which have a centralized authority in the monetary and financial fields. If we continue to have the slowdown that comes with trying to bring about constructive action in the whole nation within the framework of, and some bending over backwards in interpretation of, the B.N.A. Act. The emphasis is always on what we can find that denationalizes Canada in the B.N.A. Act, and this emphasis is a great tragedy in Canada in 1962.

The emphasis should be the other way. It should be on what is the extent of the B.N.A. Act

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in bringing us together into a common nation. Certainly all the powers to make tariffs is centralized, and that conveys with it implications of international matters in the various sectors of your social organization. The banks are a matter of national interest and control, and it seems to me that if we are going to have to bear the results in one part of the country because another part of the country at the moment can go into the United States and borrow extensively, and we lose out in some other way some years later on, then we have an interest in what is happening in any part of Canada in respect to borrowings in the United States or in any other country such as Switzerland and France. I think there is a mutual interest in this.

COMMISSIONER GIBSON: But you are not, in fact, suggesting these things should be concentrated in one place. You are saying that the muncipalities should have the right to do these things.

MR. LLOYD: Yes, because you are compelled to get the thing done in Canada you have to be careful you do not intrude on what is so often called provincial rights. If you did not have any such thing there would be no hesitation about it, but I think, insofar as borrowings outside Canada are concerned --

MR. TURPIN: The federal government has control over credit and finance. We are not asking for more control.

THE CHAIRMAN: Should we not consider this

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not only from a constitutional point of view but on its merits? Is it feasible? Would it be a useful thing to do? Would it be an improvement in the situation of the municpalities throughout the country. Those are the first things we should be looking at, but if there are constitutional difficulties ---

MR. LLOYD: We could let somebody else worry about that.

MR. TURPIN: But it comes within the power of the federal government to do such a thing because it already controls credit and finance in this country. The time might be appropriate -- I am not suggesting that this is contained in the brief, and I am not speaking for the Federation now, but I have heard it said among mayors that presently the Bank Act of Canada is giving the chartered banks the power to increase credit in circulation based on their cash on hand; that with, say, eight per cent it can lend 100 per cent, or with $8 million it can lend $100 million. If through the Bank Act the chartered banks are given this power why could not such a power be granted or given to the municipal banks of our country? Could they not, with a contribution of $8 million from the federal government or the provincial government lend the municipalities $100 million. This, again, would affect the overall picture, but with proper controls why would not this be reasonable in the municipal field?

MR. MONGRAIN: Mr. Chairman, I understand

Mr. Leman has some other questions to ask. Can we ask Mr. Leman to proceed with his questions?

COMMISSIONER LEMAN: Has this idea ever been suggested as a proper one for the agenda of one of the Dominion-Provincial Conferences?

MR. MONGRAIN: We have been trying for years.

MR. LLOYD: The Dominion-Provincial Conferences happen to have closed doors so far as municipalities are concerned. We are not welcome at those Conferences. However, this has been discussed directly with the Cabinet.

MR. MOONEY: We discussed this and had a meeting with the Cabinet in 1959 . We had a three-day session with the Prime Minister and a number of the cabinet. It was an off-the-record conference, but during the period of our three day meeting we talked about the establishment of an international municipal loan fund. We discussed the pros and cons, and we reached no conclusion, but it has been discussed as between the Federation speaking for the muncipal government and the federal government.

The problem of municipal capital borrowing, however, has been referred to at meetings as between the dominion and the provincial governments at their last few meetings.

COMMISSIONER LEMAN: What would prevent the institution of such a body on a voluntary basis through the union of municipalities itself?

MR. TURPIN: Why not organize our own bank?

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COMMISSIONER LEMAN: What would [illegible] the institution of such a body on a voluntary basis [illegible]?

MR. TURPIN: Why not organize our own bank?

Would you give us the same power that you are giving to the chartered banks?

COMMISSIONER LEMAN: Wait a second, now. I do not think we should get confused as to how banks operate, but banks before they can start lending money, have to get the people's savings in. Just because the federal government would put $8 million into this outfit does not enable it to lend $100 million unless it borrows it, or ---

MR. LOWTHER: --- or prints it.

MR. LLOYD: I think Mayor Turpin said it was an expression of his own opinion. We have not studied this.

COMMISSIONER LEMAN: Yes. There are some elements in this country that have come close to arguing that money grows on trees, but this Commission does not believe that.

MR. LLOYD: This was not the view of this Federation.

MR. MONGRAIN: I think the Federation is of the opinion it would be definitely better if we had a unique pattern, broadly speaking, all over the country, and then after that it could be adapted in each province. That might be the best reason for having a national organization.

MR. LLOYD: I wonder if it is applicable at all, but could we use Metroplitan Toronto as an example ---

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here. This is the first time I have ever heard of its being an example of anything outside of Toronto.

MR. LLOYD: Look at Metropolitan Toronto. We find some features -- when I say "we" I mean the Manitoba group -- that we think are excellent. By pooling their resources the suburban areas have certainly benefited in having one authority going to the market. There has been a saving of about $4 million a year in interest.

I am not talking about the larger cities that have established their credit, but those municipalities that are becoming urbanized and that are having difficulties in getting money, would benefit from a national bank. I think that Mr. Leman's suggestion that it be done on a voluntary basis is impossible. There must be a centralized source of funds, and I think in the interests of all of Canada the federal government should spearhead this thing. It may be that some contribution should be made by the municipalities, but that could be looked into after this is settled.

MR. MOONEY: If I may say, Mr. Leman, I think the answer to the question you have asked is that this is possible, but I think the time factor involved in bringing it about would probably be somewhere between now and the end of this century. This is the way the Netherlands municipalities went about organizing their municipal institute. That is an exclusively municipally owned, managed, operated and administered national bank. It is

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not too dissimilar from the organization in Belgium which was supported by the municipalities. So, one can assume that theoretically this is possible, but the time factor involved in doing it -- we are not ready yet.

COMMISSIONER LEMAN: What I am trying to do is follow your thought through. I am suggesting to you that if this institution was created under the auspices of the federal government,with the federal government's credit behind it, it would end up by operating cheaper than the provinces themselves.

MR. KUSHNER: Probably.

MR. LLOYD: Why would that have to be?

COMMISSIONER LEMAN: Therefore, the credit available for municipal purposes would end up by pre-empting the market. Let us say the first credit in the country now is the federal government's. Therefore, it is the cheapest, and the one that can tap the most sources. Now, this would become the second one, and that would put the provinces third; is that right?

MR. LLOYD: There is nothing to stop the provinces being a part of this picture. You could call it the provincial-municipal fund, if you like. Once the principle is accepted then we can look at it. There is no suggestion at the moment that the municipalitiy should pre-empt the field as compared to the provinces.

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MR. LOWTHER: When you look at the functions of a provincial government, and the

responsibility it discharges in our time you will find that it is not responsible for national defence; it has nothing to do with the field of tariffs; and it has nothing to do with banking and finance. Is not there something more than an analogy between the responsibility of a larger urban city and that of a province? Should they not come to realize that in this field they have the same interest?

The other side of the coin is that if you must go abroad for capital, as we are now doing, then the national interest is involved, and therefore some degree of cooperation should be there, at least, and some universal understanding of all of the elements of advantage that are seen in doing this should exist, and the timing should be known -- at least, there should be a common source of information about it -- which such a central agency would provide.

If, on the other hand, it is a bad thing to do, and you have to do less borrowing in the United States, and the national government says it is in the national interest for you to do less, then you go to the development bank and have it arbitrate as to the sharing of available funds from your own national sources. Whichever way we look at it I think we are obliged to accept this fact, aside from putting forward the plea that it is a theoretical exercise.

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MR. MOONEY: Let us assume that this national-municipal loan fund was created and it

provided a better credit in terms of the market, there being a federal approach to the market rather than a provincial approach which would, therefore, give us a higher rating ---

COMMISSIONER LEMAN: I am just trying to suggest to you that we live in a country where there are politicians and where there are certain constitutional problems involved in autonomies and that sort of thing.

MR. MOONEY: If it worked that way it might be useful to the municipalities, and it might be useful also to the provinces. Maybe this is a step towards better coordination of the capital borrowing needs of governments in the whole country.

We have not at any point in the brief mentioned the Australian loan council because we did not have that in mind. We are mindful of some of the criticisms made against the Australian loan council, but certainly there is a growing need for a better organization of the municipal borrowing needs than that which we presently have in the country, and we are suggesting this is a sensible, feasible -- I will use the three adjectives the Chairman used -- scheme. It is useful, and it is desirable.

COMMISSIONER LEMAN: That was one feature that did surprise me. In Appendix A there is no reference to the Australian arrangement. That is why I was a little bit puzzled as to exactly what your thinking is with respect to this national-provincial loan fund. The examples you give us are

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COMMISSIONER LEMAN: That was one feature that did surprise me. In Appendix A there is no reference to the Australian arrangement. That is why I was a little bit puzzled as to exactly what your thinking is with respect to this national-provincial loan fund. The examples you give us are

voluntary types of arrangement without any federal control, whereas in Australia it is the other way around. I am wondering which way your tendency is.

MR. MONGRAIN: We think it would have to be tailored to our needs. I do not think there is any other plan anywhere else that we could adopt as it is.

MR. KUSHNER: I think we should get one thing clear, Mr. Chairman. We are not suggesting for a minute that there should be centralized control over the borrowings of each individual municipality. The control, to use that word generally, must remain at the provincial level. We are just talking about a central fund from which we could draw. Perhaps we should contribute to it, but that is something that can be discussed. If we can borrow on our own resources, then not only would our credit rating be greater but the national body, which may be responsible, would be able to do something about the international money situation. Right now they have to say to us either: "Go to the market" or "Don't go to the market", and we have to do the best we can. The end result is hard on the national economy.

THE CHAIRMAN: You are centralizing all your resources. You are expecting the government to put the money into this bank.

MR. KUSHNER: Partly. For instance, there has been mention made of $50 million to $75 million a year in interest on municipal debentures --

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is in that range.

MR. KUSHNER: We suggest to the federal government that that could be the basis of the fund. That is a long way from the amount of capital we borrow annually. It may take several years to build up the fund to the proportions required. But let us get started in looking at it. So far we have had difficulty in even getting a smile from the authorities and their saying: "Maybe there is some merit in it".

MR. TURPIN: If the federal government has found it expedient to guarantee loans through the Central Mortgage and Housing Corporation and through the International Development Bank, is our proposal so ridiculous, or so different from that which presently exists at those levels?

MR. LLOYD: In this year of 1962, Mr. Chairman, there is the problem of the urbanization of our population that faces all of us at the municipal level. That has brought with it a demand for capital that did not exist before. It is up to the federal government to take a more urgent interest in our urban transportation problems. If we are going to develop as a nation then, surely, it is in the national interest to make sure that money is available for all these things.

MR. MOONEY: We really see nothing in our proposal that is too different from the Municipal Improvements Act of 1938, a copy of which I have and with which you are probably familiar, and what

is in that range.

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that law provides. We are not asking for 2 per cent money that is provided for in that statute, and which was the basis of the loans to be made. We do not suggest that there should be any less provincial controls or control over provincial capital borrowing than presently exists.

We do not suggest that any municipality applying for a loan would not be subject to the same criteria of evaluation as the market generally applies today, when it goes separately to that market for a loan. We are not asking for the sluice gates to be opened up at all. We are anticipating broadly the same processes as operate today when a municipal government goes to the money market. We believe these same processes will apply. We are merely suggesting there be created this single instrument allowing the municipalities to get together in their borrowing, and if a municipality does not wish to make use of this instrument then it is free not to.

THE CHAIRMAN: But the interest rate would be uniform irrespective of the credit worthiness of the municipality?

MR. MOONEY: We have not said that. It may reach that stage but there will be variations, the variations which exist today in terms of the market.

MR. DAWSON: The interest rates would tend to be lower.

MR. MONGRAIN: From a national standpoint it would be desirable if municipalities were brought to this stage where interest rates might be uniform, but we are not at that stage yet.

COMMISSIONER GIBSON: How would you allocate the funds available -- by provinces, and with the provinces each dividing it up among the municipalities?

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MR. MONGRAIN: You have got me in a position which is beyond what we have considered and contemplated. Now you are going into the mechanics of the matter.

COMMISSIONER GIBSON: I appreciate the sort of thing you are recommending and the desirability ofit, but I would like to get down to the problems and practicalities of it. How would you allocate funds in a situation like this? You say there would be a lot of more or less fixed interest rates. How would you divide it up, by provinces?

MR.DAWSON: It might be premature to go into all those details. If a thing like this were considered by the Federal Government it possibly might like to set up a Commission who would know about that work and work out all the details. One sure thing is that we would like to have a provincial body in each province and it would conform to what the Commission had decided. We understand it will have to be improved over a period of years. We will not find a perfect instrument right away or a perfect formula.

THE CHAIRMAN: Of course this sort of thing has been done in some provinces before, and is being done now.

MR. MONGRAIN: It is done in Alberta.

MR. MOONEY: We envisage this municipal loan fund will operate in the national field almost in the manner that the Alberta Loan Fund operates in the municipal loan field.

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MR. DAWSON: Through the provinces.

THE CHAIRMAN: I am wondering whether you are going to improve the situation by having a national fund when it is open to the provinces.

MR. MONGRAIN: Not all provinces are doing it. Not all of them are able to do it even if they wanted to.

MR. DAWSON: They all have not got oil.

COMMISSIONER BROWN: I think you are agreed right from the beginning that you are not going to have as much money available as everybody would desire. How then are you going to divide it up?

MR. LOWTHER: If the Federal Government is going to borrow the money, it seems to me from a working, practical standpoint -- I am not expressing an opinion either for or against this -- but from a practical standpoint the Federal Government, through its borrowing powers, would provide the capital and the only criterion necessary to entitle a municipality to get its capital from this fund would be prior approval by the municipal-provincial agency, the same way as you have to get approval now before you can proceed with a capital undertaking.

This would mean that potentially this fund could be expected to provide as much municipal capital as municipalities now provide themselves.

COMMISSIONER GIBSON: It is more.

MR. LLOYD: Well, looking ahead to the future, obviously our capital needs in the future will be more than they are today.

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COMMISSIONER GIBSON: But, Mr. Lloyd, surely there must be some criteria that the Federal Government must apply to judge whether it is prudent to permit a municipality to borrow how much and for what purpose?

MR. MOONEY: I have not heard it suggested in any quarter that we are incapable as a nation of raising sufficient capital funds to meet the potential increase in municipal capital borrowing for the needs that will face us in the next 10 or 20 years. We have indicated in our submission that this is of the range of probably twice the current average annual borrowing.

If $250 million has been the average over the past ten years, then to meet the social capital requirements as envisaged by the Gordon Commission Report, with which we concurred, then something in the range of up to an average of $500 million will be required each year over the next 10, 15 or 20 years.

It has not been suggested that that amount of money is not available, if the municipal governments require that amount of money. However, there is a check in balance on municipal spending, and that is the capacity of municipalities to utilize that amount of money annually, to organize for capital spending of the range of an average of $500 million a year.

As some of us envisage it, the municipalities requiring capital funds would place their debentures in the hands of the capital municipal loan fund and

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then the municipal loan fund, about three or four times a year, would go to the market on an orderly basis for whatever that amount may be. The rationing of those funds is the rationing of the application of the municipal governments. It would not be necessary to ration the funds unless their applications were severely in excess of $500 million. Neither would it be necessary for the fund administrators themselves or the provinces to ration it except only in terms of the demonstrable requests from the municipalities based on their capacity to repay. It is along that sort of line we are thinking, that the fund will operate just the way the Alberta Municipal Loan Fund operates.

MR. BEECROFT: The difficulty of rationing has not prevented the Federal Government appropriating, in the first instance, $100 million for sewer financing. Everybody knew the municipalities of Canada needed many times that much if they were going to do a job in fighting water polution. After a year or two passed, the Federal Government found it was within its capability to vote another $100 million and it is now in process of allocating that additional $100 million and we do not hear any complaints from the municipalities that there is unfairness in the allocation of that amount of money. We have confidence that the Federal Government will attempt to keep this thing going, and between the municipalities,the provinces and the Federal Government this problem can be taken

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care of.

The problem of allocation is a serious one now and it is a process which is left very much to the decision of the market, and that is very much more frustrating to the municipal governments than the kind of system of allocation which would exist if there were an orderly process of applying to the market through a central agency.

MR. MOONEY: If the Federal Government would extend sewerage loans to other municipal projects, such as streets and traffic requirements, and a myriad of other things that have to be done, and write that into built-in legislation, we would not be asking for a municipal loans fund.

THE CHAIRMAN: One of the reasons the Federal Government concentrated on sewers was that municipalities were inclined to build streets and parks but they were getting into great difficulty with their sewerage problems.

They were not dealing with them. They were dumping the sewerage into the rivers raw, as they are still doing in many parts of my own province.

MR. MOONEY: But remember, Mr. Chairman, they are still dumping thousands of new automobiles every year onto our streets. We are going to have pure water but I do not know how we are going to grapple with our streets five or ten years from now and much greater expenditures will be needed on municipal streets and highways.

MR. MONGRAIN: May I come back to the point raised by Mr. Beecroft? The federal government has made another $100 million available for this purpose. It is true that part of this was probably due to the fact that the pollution of our streams ought to be looked after, but the federal government said something more than that. The federal government has set a target for the job to be done within a certain number of years and they have promised the local governments that if it is done earlier than that they will wipe out twenty-five per cent of the money repayments.

THE CHAIRMAN: They are encouraging you to do a specific thing which they thought was in the national interest and which you were not doing.

MR. MONGRAIN: But we are suggesting that there are other things which require to be done, and to meet this serious situation we are suggesting this municipal loan fund on a strictly economic

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basis. Surely the time has come when we should look at this problem instead of waiting until we have the same situation as we have now with our rivers and streams?

MR. LLOYD: I think Commissioner Leman's question was a fair one to ask. This would have some effect on provincial borrowing. There is no doubt about that, but we must be practical. The provincial governments are also going to the American market and there might be some impact on that as well. I think a better relationship vis-a-vis the provinces and municipalities, and vis-a-vis the provinces and Canada,and vis-a-vis Canada and the foreign investor can come about by this kind of instrument which could provide money at a better price than the States and enable us to meet the obligations we are faced with.

I know, Mr. Chairman and members of the Commission, that you appreciate that we do not not have the resources available to us to comprehend all the intricacies of high finance in Canada but we do present to you humbly, and to the best of our ability, an observation and I think our report does challenge you in this field. If there is some useful purpose in it then it is for you to inquire into it.

COMMISSIONER LEMAN: What you are asking for is access to the cheapest credit in the country?

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and there is no hesitancy in saying so.

THE CHAIRMAN: And you are not ashamed about that?

MR. LLOYD: No, not at all.

MR. MOONEY: This whole problem is not merely just a Canadian problem. It is a problem which municipal governments are facing everywhere.

THE CHAIRMAN: Oh, yes.

MR. MOONEY: And our submission illustrates that fact. We Canadian municipal governments are at a severe disadvantage actually in terms of American municipal governments because of the tax exemption feature which enables them to obtain their capital funds much cheaper than we are able to obtain funds.

We have not requested or suggested that a similar exemption be allowed to owners of Canadian municipal bonds. We take the general position that we are not in favour of that because it would tend to create a favoured,privileged group of investors in the community. Moreoever, we have some doubt about the volume of that potential market so far as Canada is concerned, and we refer to that in our submission, but we think this proposal we have put forward in part, this national loan fund idea, would tend to bring us into a more equitable position in terms (a) of American cities and (b) in terms of Canadian cities generally across the country. Not all municipal governments have equal facilities and equal capabilities so far as municipal financing is

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concerned. The larger cities are in a preferred position and the smaller communities, in the past at any rate, have had difficulties with respect to capital borrowing. We believe the time has arrived when the situation should be made equitable for all local government borrowing across the country, somewhat within the framework of the idea we have placed before you.

I have attended meetings in the United States where the idea of an intergovernmental loan corporation in the States was under discussion and so, as I intimated before, it is a univeral problem. In last week's issue of The Economist there was quite an article with reference to municipal capital borrowing needs of governments in the United Kingdom. These problems arise because of the new facts of municipal life and the new needs of municipal governments that have arisen consequent upon our highly organized industrial communities.

COMMISSIONER MACKINTOSH: Mr. Chairman, I have a couple of questions which we asked a number of people across the country, and I would like to put them now and receive some brief answers to them. In the past few years we have had considerable variations of monetary policy affecting credit and rates of interest. How far in your experience have these, either by reason of the higher rate of interest or the unavailability of credit, actually influenced the actions of municipalities in undertaking capital works or postponing them?

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MR. MONGRAIN: I think, Mr. Commissioner, that what is commonly referred to as tight money or easy money policies directly may not have had much impact on the work being done by municipal governments, because the type of work which municipal governments do is either work that has to be done or has not to be done. The one type of work where it may have an effect is the kind of work in which the federal government participates, and I can give you one example of this. In my own province of Manitoba, as a result of the government policy of contributing 75 per cent of the capital costs of a secondary school, there has been a rash of secondary schools, because the local taxpayer says "I am only going to pay 25 per cent for a school. I want that school now". Otherwise it might have been postponed for a while.

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But in the ordinary orderly municipal development the demand is either there or it is not, and if it is I think the current interest rate has not as much effect as it has on other parts of the economy. At least, that is my reaction.

MR. MOONEY: There is another point in there. I would say, Dr. Mackintosh that there are four or maybe more, but there are four things that happen in a tight money situation in so far as municipal governments are concerned. There are municipal capital works projects, largely of an important nature that have to go forward, but under certain circumstances certain municipal capital undertakings can be and have been deferred because of the high interest cost. Beyond that there has been a curtailment of certain projects. That is, of a series of projects they pick out two or three of the five that they were hoping to go forward with.

Where they have gone forward with any project generally speaking under tight money conditions, the tendency is for municipal governments to temporarily finance their cost through short term runs pending a hopeful change to a lower interest cost.

Then, of course, there is the final factor. Under tight money conditions -- this is a compelling factor -- this has driven, if I may use that word, some municipal governments and particularly the larger ones to the American market.

MR. LLOYD: Non essential items, Dr.

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MR. MOONEY: There is another point in there. I would say, Dr. MacKintosh that there are four or maybe more, but there are four things that happen in a tight money situation in so far as municipal governments are concerned. There are municipal capital works projects, largely of an important nature that have to go forward, but under [illegible] circumstances [illegible] capital undertakings can be and have been deferred because of the high interest cost. Beyond that there has been a curtailment of certain projects. That is, of a series of projects they took out two or three of the five that they were hoping to go forward with.

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MR. [illegible]: Non essential items, Dr.

Mackintosh; anything that you can class as a non-essential item does get deferred if one can possibly get along without it.

This answer is broken down in this way. If you want, for example, to get down to a thirty pupil classroom instead of having fifty, or forty-five, which is considered excessive, you look at the cost of providing that service with teachers and the annual maintenance charges of maintaining the service, in that instance, much more so than you do at the interest factor. But, on the other hand, if we are going into a share cost capital improvement such as a highway in respect of which the maintenance cost is not so heavy, you do not have to provide a certain number of people at salaries per unit of capital employed for the project, you might tend to defer it, or forestall. You cannot help but say to yourself, if you have to pay 5.7 per cent interest on what we are borrowing and we are held down to a 20 year term on a thing that is going to have a benefit for 40 or 50 years, the city council will haveto go slow. When it sees this interest rate of 5.7 per cent, they realize that they have lived long enough to know that there was a time when you could borrow at 3.57 per cent. This has happened within my time and since the end of the war. Despite the overtures that have been made from time to time by national governments and national parties -- they are all alike in this field -- that they are doing these things to ease the impact of interest cost on municipalities, I challenge the

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lot of them and say that none of their policies have brought that desirable condition about.

MR. TURBIN: Again if I can give an example in respect to my city, and I think you want examples that can be placed before you, one-third of our total income today goes toward the servicing of our debt in Hull on the one hand. On the other hand we are faced with the necessity of annexing adjoining territory to provide room for an expanding population and growing city. This means that we have to increase our capacity of making water available of taking sewage away and treating it. At the council level we just wonder if we should go ahead with these annexations because, at the cost of borrowing today, we think that it might be better to delay and perhaps wait some years. We feel that the load on our property owners is quite heavy now and that it might not be fair to increase it. That is what we are faced with today in our city.

COMMISSIONER MACKINTOSH: Can I conclude that while the effect differs on various types of projects, your judgment is that the rate of interest does enter into decisions?

MR. MONGRAIN: Definitely.

MR. DAWSON: Oh, yes.

MR. KUSHNER: Yes.

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MR. LLOYD: This might not be the position taken by an administrator, but a man who gets elected to public office looks at everything that increases the tax rate on his community. He is much more conscious of every element of cost. He is aware that his opponent will attack him in this regard. The laddie who sits in an administrative office of a municipal government is not exposed to that same kind of thing and he might not take that view, that we should be making this kind of inquiry. I do say to you that an elected representative, if he has any sense of responsibility at all in respect of the matter, does take into account the impact in the long run over the years ahead, and in cities where you have commissioners of finance and in many cities, city managers such as we have in Halifax, they are looking ahead ten years, and I think you will find that they are concerned about this interest factor much more so than appears on the surface.

MR. TURPIN: Some municipalities in Quebec are faced today with a very difficult dilemma. They are forced by the provincial authorities to treat their sewage, and the health department refuses to accept any new subdivisions unless we do take steps to clean our sewage. In a case of this kind we have no choice even though we have to pay perhaps 7 or 7½ per cent. We must go ahead, otherwise the whole building industry will be affected in our area. In a case of that kind we have to pay whatever rate the market charges.

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MR. KUSHNER: I think you put it quite correctly, Mr. Commissioner, when you said that it is a fact that we defer those things we can defer. Unfortunately there are services we cannot hold back and we must accept high interest rates as a fact of life.

MR. LLOYD: And we are stuck for twenty years.

THE COMMISIONER: Well, that concludes the discussion, gentlemen. I may say it has been a very interesting and active one. We have, each one of us, learned a great deal I think about your view-points in respect of these problems. It has been all of very great benefit to us. I wish to thank you for appearing before us and for your very carefully prepared brief which is full of interesting material. It has been a very great pleasure to have had you with us today.

MR. MONGRAIN: Mr. Chairman, my colleagues have asked me to thank you and your fellow Commissioners for inviting us and allowing us to partake in this very interesting discussion. It has been said very often that mayors are close to the people. This means that we like sometimes to have the opportunity to let off a little steam, and you have given us a wonderful opportunity in this regard this morning. I think we should thank you all for that opportunity.

THE COMMISSIONER: Thank you very much, Mr. Mongrain.

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(Applause)

THE COMMISSIONER: Thank you very much, Mr. Mongrain.

We shall now adjourn until 9:15 tomorrow morning when we shall hear the brief of the Province of Ontario.

(Adjournment).

Royal Commission on Banking and Finance

CANADIAN FEDERATION OF MAYORS AND MUNICIPALITIES

Hearings held at

OTTAWA

Vol. 50A

Date. OCT.29, 19[illegible]

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

SUBMISSION TO THE ROYAL COMMISSION

ON BANKING AND FINANCE

by the

CANADIAN FEDERATION OF MAYORS

AND MUNICIPALITIES

OTTAWA,
October 29th, 1962.

RECOMMENDATIONS AND SUGGESTIONS
of the
CANADIAN FEDERATION OF MAYORS AND MUNICIPALITIES

A National Municipal Loan Fund

1. The municipalities' primary contention is that, in view of the volume and importance of basic community needs, municipal capital works are of equal priority with those of the senior governments. It is therefore fair and equitable to enable municipal governments to have the same advantages as senior governments in respect of the capital market.

2. Arising from this basic contention regarding equality of opportunity in the capital market, and in view of the great volume of requirements anticipated for community development, the Federation's main recommendation is that the Federal Government, co-operation with the Provinces, should establish a national Municipal Loan Fund (or Bank) for the purpose of facilitating the capital borrowing operations of municipal governments.

3. The case for the Loan Fund is considered at some length in the last two sections of this submission and is further supported in the detailed analysis of present municipal financing in the sections on revenue, expenditures, taxation and borrowing.

4. The establishment of such a Fund would not preclude any municipality from borrowing in the private market. It is nonetheless the general view of the municipalities that a national municipal loan fund is essential to make it easier for municipalities to raise money and to reduce interest and marketing costs.

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5. As one means of implementing the basic

recommendation concerning a municipal loan fund, the Federation recommends that the Federal Government should apply the revenues received from the taxation of interest on municipal bonds to municipal loans contracted through the proposed national municipal loan agency.

Other Recommendations

6. As a further aid to municipalities, in relation to their revenue and borrowing needs, the Federation recommends

(a) that the chartered banks, in setting interest rates on short-term loans to municipal governments for such purposes as the anticipation of taxes, government grants, and the receipt of loan money on capital borrowing and other such well-secured risks, should take account not only of the nature of such well-secured loans but of the high credit standing of the municipal governments;

(b) that provincial governments, investors and investment dealers should modity the rigid and somewhat artificial criteria -- whether statutory or "rule of thumb" -- which now stand in the way of some expansion of municipal borrowing and raise borrowing costs unduly.

Suggestions

7. There are a number of questions concerning which the Federation does not feel sufficiently informed to make precise recommendations but which

deserve intensive inquiry by the Royal Commission, followed by appropriate recommendations. These questions are discussed in this submission and may be summarized as follows:

(a) The withholding tax on foreign-pay Canadian bond issues has raised the cost of borrowing abroad. In view of recent changes in Canada's economic situation, the removal of this tax may now be warranted.

(b) In the United States, municipal taxes and mortgage interest paid by home-owners are exempt from the federal income tax. In Canada, on the other hand, the payment of income tax on amounts paid in municipal taxes represents double taxation. If such payments were exempt from income tax, the municipalities could then make fuller use of the field of real property taxation which, according to prevailing theory, is reserved for their use in raising revenue. The taxation of home mortgage interest in Canada serves as a further limitation on the municipalities' power to tax real property to pay for local services.

(c) Present federal tax law puts municipalities and other governments at a disadvantage in comparision with corporations who can charge bond interest as an expense. This means, in effect, that corporate taxes are reduced by approximately one half of the interest paid.

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(c) Present federal tax law puts municipalities and other governments at a disadvantage in comparision with corporations who can charge bond interest as an expense. This means, in effect, that corporate taxes are reduced by approximately one half of the interest paid.

Furthermore, investors pay full income tax on interest from bond issues, whereas a tax credit is allowed on dividends from Canadian common and preferred stocks. More equitable tax treatment would broaden the market for municipal and other government bond issues.

FOREWORD

(a) The Canadian Federation of Mayors and Municipalities is a national organization created and maintained by the municipal governments of Canada for the purpose of nation-wide inter-municipal co-operation and common undertakings (1). It was founded on the proposition that while local governments operate within the framework of the law and tradition provided by their own provinces, municipal governments also have many problems which can best be approached through nation-wide study and concerted action.

(b) In the pursuit of its purposes the Federation convenes an annual conference and maintains a year-round program of enquiry and research into various municipal problems and acts as a central repository for the exchange of information on matters of general municipal interest and concern.

(c) Among these matters -- of highest concern -- is the central problem of municipal finances .... The problem goes back many years and may be thought of as having three facets:

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2. THE PRESENT .... Municipal governments are therefore confronted with this backlog of unmet requirements plus the pressing need for extended and modernized municipal plant and other community facilities necessitated by rapid urban growth and public demand for new and improved municipal services .... The redevelopment of the older sections of cities and towns has become both an economic and functional necessity .... Since 1945 there has been a substantial volume of municipal capital works and improvements, but it has been far short of the demonstrable need .... The annual municipal costs of these undertakings have pyramided the local debt burden to a disproportionately high percentage of the annual revenues available to municipal governments for all purposes.

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must also anticipate the continuing and foreseeable growth and development needs which inevitably every community must contend with .... The volume and nature of the foreseeable urban growth and re-development need within the next ten to twenty years will entail an outlay of social capital that will be beyond the debt-carrying capacity of municipal governments to afford within the framework of their present tax and revenue structure.

(d) Municipal governments are aware of these needs. They are also aware of the crippling financial limitations which prevent or delay the carrying out of desirable and, in many cases, urgent municipal improvements. While they are minded to get on with the job of making our cities and towns functionally more efficient as well as to provide those community amenities which we have come to associate with modern standards of good urben living, their ability to do so is singularly dependent on a rigid taxation revenue base that severely limits major debt obligations much beyond that to which they are already committed.

(e) The problem of the municipal taxation and revenue structure is a matter which the provincial governments will have to contend with, but the related problem of the borrowing requirements of municipal governments has implications which are nation-wide in nature and, in the view of the municipal governments, a national approach and national policy -- at least with respect to some aspects of the problem -- has become

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a matter of considerable urgency.

(f) In seeking remedial measures from the senior governments, municipalities are at a disadvantage as a result of the serious under-representation of urban voters in both federal and provincial legislatures. The allocation of funds by senior governments for capital development projects reflects a built-in bias against the requirements of the rapidly growing urban areas. The citizens of our urban communities must therefore not only provide much of the money for rural development projects of the federal and provincial governments, but also carry the cost of their own municipal improvements and public works.

(g) Municipal finance problems can be accentuated -- and frequently are -- by the fiscal and monetary policies of the Federal Government. The more significant effects can be listed as follows:-

1. The over-riding dominance of the Federal Government in the long-term bond market means that municipalities have to compete for funds -- at a disadvantage -- in a limited market.

2. Federal action to restrict credit may mean a cut-back in capital spending for some municipal public works. For other vitally needed municipal undertakings it imposes a higher interest cost.

3. The policies of the Federal Government in promoting private capital investment, such as housing and other federally-

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facilitated developments, while of benefit to the economy as a whole, nonetheless place a burden upon the municipalities to provide the services required by such undertakings which may place a strain on the credit of the municipality.

(h) It is because of such considerations that the Federation -- on behalf of municipal governments -- places the following general summary of the municipal finance and related capital borrowing problems before the Royal Commission on Banking and Finance.

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B. CONSTITUTIONAL BACKGROUND AND SYSTEM OF MUNICIPAL GOVERNMENT IN CANADA

(a) Under the British North America Act, the municipalities are the creations of the Provincial Governments. The several provinces, therefore, have complete jurisdiction and control over their respective organizations of municipal government ... The division of the constitutional powers, rights and privileges between the Federal and Provincial Governments, is contained principally in Sections 91-92-93 of the Act.

Section 91 gives the Federal Government certain financial powers which have an indirect impact on Provincial, and, thereby, Municipal Government Finance and Administration.

Section 92 (Par. 8) establishes the authority of the Provincial Governments to create local governments and to delegate to them certain powers vested in the Provincial Governments by the B.N.A. Act.

Section 93 gives provincial legislatures exclusive authority to make laws in relation to education, subject to certain safeguards for the rights of religious minorities.

(b) Municipal government in every province of Canada existed in elementary form prior to Confederation. It is understandable, therefore, that the provision of the British North America Act that gave complete

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(b) Municipal government in every province of Canada existed in elementary form prior to Confederation. It is understandable, therefore, that the provision of the British North America Act that gave complete

jurisdiction over "municipal institutions" to the provinces has resulted, quite naturally, in dissimilarity in the organization of local government both within and as between the several provinces. This stems not only from the difference in the beginnings of municipal governments and their subsequent independent growth in each province, and also from variations in requirements arising out of geographical and population differences.

(c) The situation remains in a state of flux, with constant amendment of provincial Acts and municipal charters in the attempt to solve old problems and to meet new ones. Just as the call for new and additional services has enlarged the scope of federal and provincial activities, the municipalities have had to assume responsibilities unheard of, or considered beyond their sphere of activity, a few decades ago. As a result, amendments to Provincial-Municipal Acts have varied from those enlarging the powers and the boundaries of municipalities, to those establishing closer provincial control and greater financial aid.

C. SERVICES RENDERED BY MUNICIPAL GOVERNMENTS

(a) Generally speaking, a municipality can be defined as being "an organization of citizens locally to provide for themselves collectively services which could not so well be proviced for themselves individually."

(b) In the early days of local government,

municipal functions and services coincided pretty much with the express conditions of this definition. Demands for services were modest, dictated largely, if not wholly, by the local citizenry who were the sole users or beneficiaries, so to speak, and by and large the costs of these services were met out of purely local resources.

(c) The situation today, however, is vastly different. The range of services provided by municipalities has been greated extended and, by their nature, are more costly than in an earlier period. In addition, certain present-day services are dictated not purely by local demand, but stem from Federal and/or Provincial action or authority. Moreover, the nature and extent of some municipal services and facilities are necessary because of "metropolitan" and "regional" user requirements. As a consequence, the benefits from certain services do not accrue solely to the local citizens of a community nor do they stop at its territorial boundaries.

(d) For these and other reasons the municipalities have, over the years, become more and more dependent upon provincial governments for assistance in the form of grants, subsidies and contributions towards the cost of maintaining the expanding and increasing variety of municipal services.

Service Functions

(e) Municipal services today fall within seven broad functional categories, e.g.:

1. Protection to Persons and Property:

Fire and police protection; law enforcement (Local Courts and contributions for joint civil or criminal justice Courts;) corrective institutions (gaols, detention homes, reform institutions, etc.); protective inspection (building, plumbing, electrical, etc., inspection); street lighting; destruction of pests.

2. Public Works:

Streets and roads (including bridges, viaducts, expressways, subways and tunnels, airports, ferries, grade crossing eliminations); sidewalks, waterways (dredging, deepening and widening non-navicable streams or rivers, etc.); snow and ice removal; drainage (other than sewers); urban renewal and re-development (slum clearance, public housing, traffic improvements, etc.).

3. Sanitation and Waste Removal:

Storm and sanitary sewers; sewage treatment and disposal;street cleaning and flushing; garbage and waste collection and disposal.

4. Health and Social Welfare:

Health regulation and inspection; control of communicable diseases; maternal and child health; clinics and laboratories; medical, dental and allied services (including nursing and pharmaceuticals); hospital care (including grants); administration of aid to aged and

blind persons; and to unemployables and unemployed employables; mothers' allowances; child welfare; charitable and other welfare institutions.

5. Education:

Elementary, secondary and technical or vocational school education.

6. Recreation and Community Services:

Recreational services such as community centres, tennis courts and gold courses, swimming pools and beaches, skating rinks and arenas, amusement parks and playgrounds; and community services such as libraries, museums, art galleries, exhibitions and fairs, parks, tourist camps, convention halls, civic theatres, local airports, off-street parking, local port facilities, and markets.

7. Utility Services:

Water, transportation, light and power.

Overhead Services

(f) Superimposed upon the foregoing are the "overhead" services, the Executive, Legislative and Administrative branches of municipal government, which do not in themselves represent a direct service to the public but rather a service to the various other departments so that they, in turn, may carry out the activities of their respective responsibilities as efficiently and economically as possible. These include the offices of elected representatives and appointed permanent officials and the general expenses for

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D. SOURCES OF MUNICIPAL REVENUE

Real and Other Property Taxes

(a) The major part of municipal revenue is derived from the real property tax which is universally employed in all of the ten provinces. In five provinces, personal property is also taxed. The tax on personal property (such as household goods and effects, stocks or bonds, automobiles, machinery and other equipment), while used quite extensively in the early years of local government, has generally lost favour. It is difficult to administer and since it is also usually subject to a wide variety of exemptions, many inequities arise. The revenue yield from it is not relatively important.

(b) In addition, larger municipalities (and some smaller ones) also have some form of a tax on business, over and above the real property tax. The business tax may be based upon the value of real property or a proportion thereof or it may be otherwise independently calculated, such as on a value based on the number of square feet of floor space occupied, rental value or gross sales or turn-over wolume of business.

(c) Some cities, in two provinces, also tax "households" or "occupancy" of households based on either the real property value or the rental value of the premises occupied. It applies to both owners and tenants in some instances, and to tenants only in others.

Other Taxes

(d) In addition to the taxes based on property and other types of assessed valuations, other sources

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Other Taxes

(a) In addition to the taxes based on property or types of assessed valuations, other sources

of taxation employed by municipalities are: The Poll Tax -- a capitation or head tax, levied usually only on male inhabitants, but within prescribed limitations, although sometimes including females; the Amusement Tax -- a tax on admissions to certain prescribed forms of amusement; and the Sales Tax -- a tax on sales of goods or commodities.

(e) The municipal sales tax is employed only in two provinces and in each instance the tax is administered and collected by the Province. The amusement tax also is employed only in two provinces. In one province the tax is imposed by provincial statute but collected by the municipalities which retain part for their own use and the remainder is paid over to the province. The amusement tax is not an important source of municipal revenue.

Miscellaneous Revenues

(f) Other revenues of municipalities, aside from grants and subsidies from other governments, are derived from a variety of sources: Licenses and Permits prescribed mainly for the purpose of regulation and control, such as for professional and business activities, places of amusement, vehicles, animals, etc.; Rents, Concessions and Franchises and Service Charges, for the use or provision of public facilities; and revenues derived from the operation of various kinds of Recreational and Community Service activities.

Municipal Utilities

(g) Utility services such as for water, transportation, light and power, also constitute an important

[illegible]

[illegible]

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[illegible]

(g) [illegible]

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municipal function, although (except for water) they are functions mainly in the larger urban communities. Utilities are usually operated on a self-sustaining basis, the charges to the customer or user thereof being based (generally speaking) on the cost of operation, the utility plant and equipment, including overhead, depreciation and other fixed charges. There are instances, however, where this is not so, and also instances where the rates for utility services are intentionally fixed to yield a surplus for general municipal purposes.

(h) Accordingly, only the net profit or loss arising from the operation of the utilities, to the extent that such may be permitted or determined by law, is reflected in most municipal budgets.

Government Grants

(i) Not the least important source of municipal revenue is in the form of government grants. These have been increased and extended in recent years and are now an established part of our system of municipal finance. In fact they constitute (in most, but not all orovinces) the second largest source of municipal revenue.

(j) The nature and extent of present-day grants varies from province to province as also does the purpose for which the grants or contributions are made. Also, there is wide variation in the basis established for administering or determining the amount of grants to be paid in any year, such as grants based on assessment, per capita grants, shared-revenues, shared-costs of

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services, per diem grants and grants-in-lieu of taxes.

Exemptions and Tax Burden

(k) The relative burden of municipal taxation as between provinces or municipalities may be affected by a number of factors. First, and probably the most important, is the extent and nature of exemptions from property or other taxes based on assessed valuations. These include the statutory exemptions of Government, Religious, Educational and Charitable Institutional property and that of private business or enterprise where such is wholly or partially exempted by statute in western provinces.

(l) In addition, there are the exemptions arising from the granting of a "fixed assessment" or a "fixed tax", mainly to industry and housing projects; the right to assess property at only a fixed or stated percentage of full value which results in an exemption of the remaining portion; or those arising from authority to levy taxes on less than the gross assessment or on less than the maximum valuations which may be taxed, as the case may be.

(m) These factors, therefore, affect the municipal tax base and also result in incomparabilities in the relative burden of taxation, depending on the basis of the assessment or the extent that the different jurisdictions tax the assessed valuations of real or other property, etc. Similarly, these same factors affect the comparability of "mill rates".

(n) A further factor affecting the relative burden of municipal taxation in the several provinces is the

per diem grants and grants-in-lieu of taxes.

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(n) A further factor affecting the relative burden of municipal taxation in the several provinces is the

variation that exists in the distribution of responsibility for administering and maintaining services as between the separate provinces and their municipal governments, and also the amount and extent of provincial grants or subventions towards the cost of services administered by the municipalities.

E. REVENUES OF MUNICIPAL GOVERNMENTS AND TRENDS

(a) The aggregate net revenues of municipal government (excluding gross debenture issues) increased in actual dollars from $294 million in 1933 to $1550 million in 1959.... The various sources of municipal revenues during this period were as follows:

Revenue Sources	Years (Million of Dollars)					
	1933	1939	1946	1951	1956	1959
A. TAXATION						
Income Taxes	4	4	-	-	-	-
General Sales	-	5	12	27	51	74
Other Sales	-	-	-	2	3	3
Real and Personal Property	231	243	275	531	860	1196
Other Taxes	18	23	29	10	10	8
Total	253	275	316	570	924	1281
B. DIVERSE SOURCES						
Privileges, Licenses, Permits	5	7	9	13	20	25
Government Enterprises	6	10	16	29	35	45
Other Local Revenues	30	25	34	48	78	108
Total	41	42	59	90	133	178
C. GRANT AND SUBSIDIES						
Provincial Governments	-	5	7	24	52	91
D. RECAPITULATION						
A. Taxation	253	275	316	570	924	1281
B. Other than Taxation	41	42	59	90	133	178
C. Provincial Subsidies, Etc.	-	5	7	24	52	91
Total	294	322	382	684	1109	1550

Comment

(b) The above table is in actual dollars and, therefore, does not reflect the relative change in price levels during the period.... While there is no price deflator or index which can be satisfactorily applied to the municipal price sector, it is reasonable to assume that the purchasing power of a 1959 municipal dollar compared with a pre-war 1933 dollar was about 40 cents.

(c) If we accept this estimate (some would argue it is greater and some would contend it is less), then the overall conclusion to be drawn from the above table is not that municipal purchasing power increased 500% between 1933 and 1939

- from approximately $300 million to $1550 million -

but, rather, the increase in relative purchasing power was about 100%

- from $300 million to 40% of $1550 million; or $620 million.

(d) Bearing in mind the relative purchasing power of the pre-war and post-war municipal revenue dollar, the trends indicated by the above table can be summarized as follows:

1. The major increase in revenue has been from the taxation of real and personal property: from $231 million in 1933 to $1196 million in 1959 .... As the table indicates, revenue from property taxation did not change materially during the depression and war years. The post-war program of new housing construction had its first impact on municipal revenues in 1946 and during subsequent years has been an increasing source of municipal tax income. New industrial, commercial and institutional construction has also added a large and growing volume of property tax revenue. In addition, most municipalities now re-assess property for tax purposes at recurrent periods and the higher assessed values are also taxed at a higher mill rate .... The property tax continues to be the mainstay of municipal finance and over the period there has been no significant change in its relative importance. In 1933, it accounted for approximately 78.5 per cent of the aggregate of all municipal revenues and, in 1959, it accounted for 77.1 per cent, a decline of 1.4 per cent.

2. A municipal income tax imposed by Montreal, Saint John and Moncton was discontinued in 1943

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as a requirement of the Federal-Provincial Tax Rental Agreements. At the time it was discontinued, it was producing approximately $4 million annually.

3. Municipal sales taxes were first imposed in the Montreal metropolitan area. Subsequently, other municipalities have resorted to their use but, mainly, in the Province of Quebec. In 1959, they produced an aggregate revenue of $77 million.

4. There has been little change in other sources of municipal revenue such as privileges, licenses and other miscellaneous items. Municipally-owned utilities have produced small but growing surpluses. The only exceptions -- and these mainly since the end of the war -- have been local bus and transit systems. While some have shown modest operating surpluses, most of them are marginally operated and a number have experienced recurrent annual deficits.

5. Some municipalities are now imposing service charges for such municipal services as sewers, snow removal, etc. However, the practice is not general although the trend is increasing.

6. The most significant new factor in the municipal revenue structure is the increasing extent to which provincial subsidies and grants have become a built-in feature. In 1939, provincial

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grants and subsidies amounted to approximately $5 million. In the subsequent years such payments have continued to increase and in 1959 they aggregated $91 million.

F. THE BURDEN OF MUNICIPAL TAXATION

(a) It has been suggested that municipal governments are not fully utilizing the property tax as a means to increase local revenues. This view is not shared by municipal administrators who feel that, generally speaking, property is now being taxed at a level beyond which it would be dangerous to go.

(b) A recent study by Prof. Irving Jay Goffman (1) throws an interesting light on this question. The purpose of the study was "to estimate the amount of Canadian taxes paid by typical Canadian families at different income levels". In the aggregate, it was estimated that just over $6 billion in taxes was paid by Canadian persons to the three levels of government in 1957. Of this, about$4.2 billion went to the Federal Government, $831 million to the provinces and $903 million to local governments.

(c) With respect to the municipal tax burden, Prof. Goffman's estimates are significant .... By using $4000 as the dividing line between "low" and "higher" incomes his study indicated that 25 per cent of the total tax collections of all governments came from the low

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income tax-payers who constitute 57.5 per cent of the approximately 5 million taxpayer units covered by the survey. By level of government this income group contributed 22.8 per cent of the federal revenues, 25.8 per cent of the provincial revenues and 31.4 per cent of the funds raised by local governments .... from which it can be concluded that the lower income group have a greater relative importance to the fund raising activities of municipal governments than have the higher income groups.

(d) The $4000 to $7000 "middle" income group accounted for 34.6 per cent of the aggregate of all taxes and by level of government they contributed 34.4 per cent of the federal revenues, 34.3 per cent of the provincial and 35.5 per cent municipal .... Taken together, the lower and middle income groups ($0 to $7000) accounted for 59.5 per cent of the aggregate of all taxes and by levels of government their contribution was 57.3 per cent federal, 60.0 per cent provincial and 69.6 per cent municipal.

(e) Still using Prof. Goffman's estimates we find that the $7000 and over income group paid 40.5 per cent of the aggregate of all taxes. The percentage paid to each level of government by this income group was 42.7 per cent federal, 40.0 per cent provincial and 30.4 per cent municipal .... In effect, roughly 70 per cent of all municipal taxes is collected from those with incomes of less than $7000.

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of the total tax paid which means that 70 per cent of the property tax -- which accounts for 93 per cent of all municipal tax revenues -- is paid by those with incomes less than $7000.... Any significant increase in property taxation will, therefore, be highly concentrated in this group.

(g) It is the contention of municipal administrators that the capacity of the "average" tax-payer to pay a higher property tax is extremely marginal. Consequently, most municipalities are reluctant to increase their revenues from this source much beyond those presently prevailing, except only insofar as such revenues are augmented through community growth. The problem is well illustrated by the graph on the following page. While it portrays the situation in the City of Vancouver it has equal applicability in most municipalities across the country.

(h) The graph, based on the years 1955 to 1962, compares the per capita increase in taxation with the ratepayer's ability to pay as reflected by the increase in weekly wages and salaries based on the industrial composite index.... The graph indicates that, for this period, total property taxation for general and school purposes has risen at a greater rate than have the earnings of the average taxpayer. If this disparity of increase continues, it is obvious that a point in time will soon be reached when municipalities cannot further increase property taxes beyond the level they have already reached. For many taxpayers in most municipalities this point in time has already been reached.

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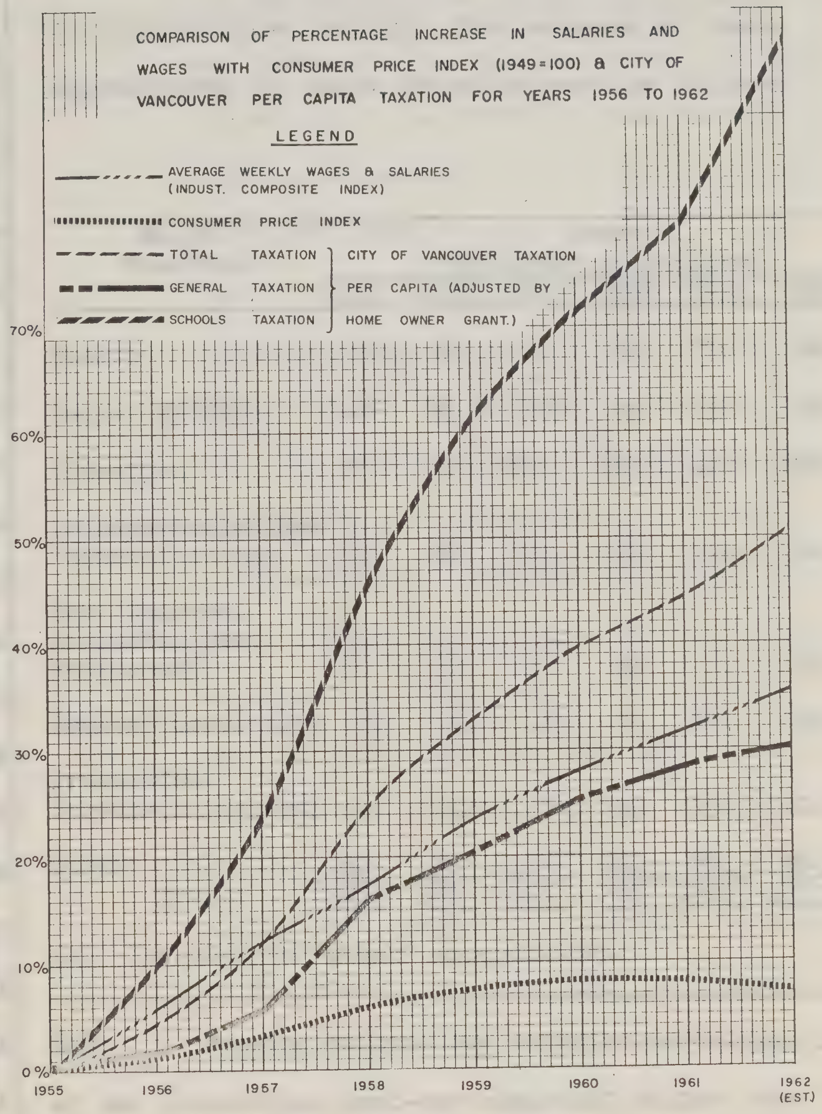
COMPARISON OF PERCENTAGE INCREASE IN SALARIES AND WAGES WITH CONSUMER PRICE INDEX (1949=100) & CITY OF VANCOUVER PER CAPITA TAXATION FOR YEARS 1956 TO 1962
LEGEND
AVERAGE WEEKLY WAGES & SALARIES (INDUST. COMPOSITE INDEX)
CONSUMER PRICE INDEX
TOTAL TAXATION
GENERAL TAXATION
SCHOOLS TAXATION
CITY OF VANCOUVER TAXATION PER CAPITA (ADJUSTED BY HOME OWNER GRANT.)
70%
60%
50%
40%
30%
20%
10%
0%
1955
1956
1957
1958
1959
1960
1961
1962 (EST.)

G. EXPENDITURES OF MUNICIPAL GOVERNMENTS AND TRENDS

(a) The aggregate net general expenditures of municipal governments, including capital expenditures, increased in actual dollars from $303 million in 1933 to $1853 million in 1959. The purposes of these expenditures (by major function) were as follows:

Major Functions	Years (Millions of Dollars) 1933	1939	1946	1951	1956	1959
Health	15	16	21	41	70	68
Social Welfare	42	35	39	25	34	38
Education	77	87	118	283	440	658
Transportation and Communications	27	28	67	123	226	346
Debt Charges, Excluding Debt Retirement	60	52	32	36	67	118
General Government	(A)	(A)	(A)	55	101	129
Protection: Persons & Property	(A)	(A)	(A)	102	156	212
Other	82	88	114	122	221	284
Total	308	306	391	787	1315	1853

(A) Included in "other" expenditures.

(b) Bearing in mind the relative purchasing power of the pre-war and post-war municipal dollar, the aggregate volume of municipal expenditures -- valuewise -- increased about 250 per cent. The expenditure trends -- in actual dollars -- can be summarized as follows:

1. The most striking increase has been in education costs. In 1933, they amounted to $77 million and, by 1946, had reached $118

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Functions	(Millions of Dollars)					
	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
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1. The most striking increase has been in education costs. In 1933, they amounted to $77 million and, by 1945, had reached $115

million. In the subsequent post-war years they have mounted steadily. By 1951, they had risen to $283 million and, in 1959, to $658 million; or approximately one-third of the aggregate of municipal expenditures for all purposes.... (In many municipalities school costs now absorb as much as 50 per cent and 60 per cent of the total municipal tax revenue dollar).

2. Expenditures on <u>transportation and communications</u> (mainly streets and highways) were at a low ebb during the depression years and, for the most part, were for annual street maintenance.... A program of new road construction got underway during the post-war years and between 1946 and 1951 the annual expenditures increased from $118 million to $283 million. Between 1956 and 1959 the annual increase was from $226 million to $346 million.

3. <u>Health costs</u> have risen steadily but moderately during the period. In 1933, they amounted to $15 million and, in 1959, to $68 million.

4. <u>Social Welfare costs</u> declined during the period from $42 million in 1933 to $38 million in 1959. The decline in municipal social welfare costs is a reflection of the fact that many of the welfare costs for which municipalities were responsible during the pre-war years (unemployment relief, etc.) have now been assumed, in large part, by the

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federal and provincial governments.

5. Annual Debt charges (excluding debt retirement) declined from $60 million in 1933 to $32 million in 1946. This period covered the depression and war years and, during these years, municipal capital borrowing virtually came to a halt. It was not until after the Korean war that municipal governments were in a position to undertake any substantial new capital improvements. Since that time there has been a progressive program of municipal capital works which accounts for the annual increase in debt charges from $36 million in 1951 to $118 million in 1959.

H. FACTORS AFFECTING MUNICIPAL BORROWING

(a) In 1933, total municipal bonds outstanding reached a pre-war high of about $1.2 billion (net, a level which was not exceeded until 1951. By the end of 1961, the comparable total was $4.5 billion, excluding sinking fund investments but including municipal issues guaranteed or bought by the provinces. The following table shows the rise of municipal debt over the period 1933-61, with the aggregate divided between urban and rural areas.

OUTSTANDING MUNICIPAL BONDED DEBT INCLUDING PROVINCIAL GUARANTEES [1]

Selected Years ($ Millions)

	1933	1939	1946	1951	1956	1961
Schools (Gross)	$ 234	$ 209	$ 181	$ 313	$ 808	$ 1520
Highway (Gross)	307	256	160	226	386	611
Other Utilities (Gross)	497	521	405	496	756	1319
Gross Items	1038	986	745	1035	1950	3650
Less: Sinking Funds	157	196	124	99	91	120
Above Items (Net)	881	790	622	936	1859	3530
Public Utilities (Net)	297	238	165	313	619	897
Guaranteed (Net)	64	55	46	52	135	161
Direct and Guaranteed Bonded Debt (Net)	1242	1082	833	1301	2613	4570
Of Which Urban [2] [3]	1171	1028	796	1169	2339	4074
Rural [2]	71	54	37	132	274	496

NOTES:

1. Includes provincially guaranteed municipal and school bonds and loans to municipalities from provincial funds provided for that purpose.

2. The division between urban and rural was changed in 1956 and the figures for that and following years are not comparable to earlier years.

3. Includes all cities, towns, villages and all other municipalities in metropolitan and major urban areas as defined in Census of Canada 1956.

SOURCE: Bank of Canada Statistical Summary Supplements 1954, 1960 and 1961.

(b) Virtually all municipal governments have need to borrow funds either (a) to tide them over a period -- generally of short duration -- when their own resources are at low ebb or (b) for the purpose of financing local improvements or other capital works. For the latter purposes, there are two major categories of municipal borrowers:

1. The municipalities -- mainly the small ones -- which rarely go to the market.... This type of municipality is likely to experience difficulty in marketing its debentures. The fact that it seldom goes to the market ought to be in its favour. But since it is unknown and because it is not a regular borrower it may have to pay a higher interest rate than a comparable but better known municipality having an established rating.

2. The municipalities -- mainly the larger ones -- which go the market frequently.... This type of municipality has a heavy

investment in construction and engineering staff to maintain a continuing program of local improvements and other needed works projects. It must therefore be assured of a continued flow of credit, both short and long-term. To this type of community, which is usually a growing one, an adequate supply of credit is almost as important as its ability to tax.

(a) Insofar as short-term municipal borrowing is concerned it is generally for one of two purposes:

1. To meet the costs of current municipal expenditures during a period prior to the replenishment of municipal funds through the payment of local taxes or of other assured municipal revenues (e.g. government grants and subsidies).

2. To finance the interim costs of local improvements and other capital works projects pending arrangements being made for their long-term financing.

(d) Insofar as long-term municipal borrowing is concerned, it is resorted to in order to finance those major capital expenditures which cannot be met in their entirety from the foreseeable short-term revenues of municipal governments and which, therefore, require to be financed by borrowing long-term funds repayable either (a) by serial debenture repayments over an extended period of years or (b) in their entirety at a fixed future date.

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(e) There is no set of rigid rules whereby a municipal government determines its borrowing policy but, in general, it is guided by the following considerations:

1. The cost of short-life capital assets (e.g. automotive, accounting and office equipment, parks and playgrounds accessories, etc.) are generally absorbed in the current budget and paid for in their entirety from current revenues. Generally they are not financed by capital borrowing.

2. The limits prescribed by some provinces for municipal borrowing and the rule-of-thumb standards used by the market for judging the credit worthiness and debt-carrying capacity of a municipality.... for example, 20 per cent of the assessed value of taxable property, or the existing per capita debt. There is a growing feeling among investors as well as municipal finance officers that there are other factors which are of equal or even greater significance in evaluating the credit risk or strength of a municipality. (See paragraphs (f) to (n).

3. Revenue-producing capital works projects which provide a desirable or needed service may receive prior consideration for early completion (and, therefore, for capital funds).

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Short-term bank borrowings (as previously indicated) are generally (a) in anticipation of tax or other payments due to the municipality or (b) in anticipation of completing arrangements to float a long-term debenture loan.

5. The timing of bond issues is an important factor in municipal capital borrowing. The main endeavour is to reach the market at a time when interest rates and other market considerations are most favourable. Pressures arising from high interest rates and tight money may temporarily defer borrowing in whole or in part.

Municipal Debt Limitation

(f) The matter of municipal debt limitations has been under expert study in the United States by the Federal-appointed Advisory Commission for inter-governmental Relations. In one of its recent reports ("State Constitutional and Statutory Restrictions on Local Government Debt") the Commission expressed concern with respect to the inelasticity and restrictive nature of most State laws and regulations pertaining to municipal borrowing and the observation was made that, unless such regulations are drastically revised, the functional and political independence of local governments is in danger of being stifled and the self-generated growth of the nation's communities seriously thwarted.

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concern with the borrowing practices and powers of local governments subject to their jurisdiction. It questions, however, the means employed to implement their supervisory power and it makes the observation that the main body of State laws with respect to municipal debt limitation is "a fabric of patches" conceived in expediency and with little regard for the vast changing needs of most communities.

(h) The Commission found that "no single formula now in effect appears to provide a reasonable and equitable measure of 'safe' debt carrying capacity of individual local governments".... It deplores the widespread adherence to a State-imposed limit on local indebtedness, predicated on a percentage of the local property tax base, as an anachronism that has persisted too long and is today rife with more weaknesses than ever before.... Similarly, it finds little merit in a formula which is based on the concept of a dollar amount per capita -- if only because this, too, is sadly out of date and fails to take into account the almost insurmountable difficulties entailed in matching population figures with money needs, particularly at times when money is actually needed.

(i) Moreover, the Commission found that using such formulae as measuring a community's economic capacity in terms of the personal income of its residents, or even setting a ratio of borrowing to a government's total current revenue, as too restrictive simply because neither takes into account that the capacity to repay may be greatly enlarged or greatly diminished in any

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community almost over night.

(j) Instead, the Commission urges that the States seek a new formula, perhaps a modification of some of the better elements of those now in use, but, certainly, a new one which will realistically meet the requirements both of the present and the foreseeable future.

(k) As a step in that direction, the Commission suggests that the States rid themselves of statutory restrictions on the borrowing power of their subordinate communities.... "These restrictions handicap self-reliance of local communities and governments", in states, and impel them towards increased dependence on State and Federal resources.... "In many States, present provisions have contributed to complexity and deviousness in local debt operations", and it adds, "action to remedy this sorry situation is both urgent and necessary."

(l) The Commission was of the view that local governments should be granted maximum powers to manage their own debt problems with the role of the State being "to facilitate -- rather than hamper -- the intelligent choice among suitable alternative forms of borrowing by the local governments concerned."

(m) In effect, after carefully studying the whole problem of municipal debt in the United States, the Commission has said, "let those who have been chosen to govern, govern -- and that function of governing includes, among other things, the exercise of good judgment in borrowing."

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(U.S.) has equal applicability to the Canadian situation insofar as municipal debt limitations are concerned. Because of this the report should commend itself to the Royal Commission as well as to provincial regulatory authorities, bond buyers and dealers.

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I. SOURCES OF BORROWED FUNDS

Borrowing in the Short-term Market

(a) Municipal governments, in the aggregate, are prime customers of the chartered banks. Their current annual revenues, now running in excess of $1.5 billion, flow through banking channels and most of their short-term credit needs are arranged, in one form or another, through their local bank. Municipalities are mindful of the importance of maintaining good banking relationships and most of them have established for themselves a high credit rating. They are large depositors and large bank borrowers.

(b) As a depositor, it is the general routine for a municipality to deposit its day-by-day tax and other revenues in the bank (or banks) in which it has an account. These deposits are usually placed in the municipality's current account pending the transfer of any unneeded surplus into short-term interest-earning investments. The remaining credit balance (needed to meet the impending expenditure requirements of the municipality) is not subject to bank interest earnings. Credit balances are frequently of a substantial nature. (Some large municipalities apply their credit balances against outstanding bank loans for the purpose of calculating interest payable to the bank.)

(c) Most chartered banks buy short-term issues of municipal debentures, particularly from municipalities who are depositors of the bank.

(d) <u>As short-term borrowers</u>, municipalities have three basic needs. They are:

(1) Short-term loans in anticipation of tax payments or other assured pending payments (government grants, etc.). Such loans are generally substantial and may be for a period of several months.

(2) For recurrent but relatively short periods (generally from a few days to a week or so) when current expenditures are temporarily in excess of their current bank balance.

(3) For expenditures on capital works projects pending an appropriate timing for the issue and sale of long-term debentures on the bond market.

(e) Interest on such loans is usually at the prime bank rate which for some time has been 5½ per cent but which was raised recently to 6 per cent.

(f) Municipal officials feel that these rates are excessive for tax anticipation and other such well-secured short-term loans. They claim that the established high credit rating of most municipalities warrants a substantially lower rate. The contention of the District of Burnaby on this subject in its Submission to the Royal Commission would be endorsed by municipalities throughout Canada.

(g) The continuing high prime rate on short-term bank loans has been a factor in diverting municipalities to the money market for short-term financing and substantial borrowing from this source occurred in 1962.[a]

(a) In the spring of 1962 there were a number of issues of municipal paper sold privately at a discount, bearing coupons of 2 per cent, maturing in two to four months, and costing the municipalities 2.83 per cent to 3.65 per cent. All were issued by municipalities having a population in

The experience of the City of Winnipeg is indicative of the trend in other large municipalities.[b] Winnipeg commenced issuing its own paper for short-term borrowings early in 1962. Notes were issued for periods ranging from fourteen up to sixty-one days. As of mid-August, the total of such borrowings in 1962 amounted to $6.5 million for an average term of about thirty-three days. The average interest cost to the City of these borrowings was about 2-3/8 per cent below the bank rate for borrowing by way of overdraft.

(h) It is likely that the larger municipalities will resort increasingly to the money market for their short-term borrowing requirements. For other municipalities, a government-sponsored municipal loan corporation (or some equivalent body) could well satisfy municipal needs for seasonal loans at low rates of interest. The corporation could issue its own paper, or finance out of pooled municipal deposits or other funds obtained from the sale of longer term issues.

(i) The recent decision of Canadian banks to discontinue short-term lending by way of overdraft and to revert to providing credit exclusively by promissory note is viewed with some concern. The effect of this decision will be to further increase the cost of bank borrowings to municipalities. The municipalities feel strongly that the decision of the banks has been made without fully recognizing the essential differences between private, corporate and municipal borrowings.

(b) Other municipalities issuing their own paper in 1962 included: Metropolitan Corporation of Toronto, Hamilton, Ottawa, Brantford, Vancouver, District of Burnaby, Greater Vancouver Water District, Greater Vancouver Sewarage and Drainage District.

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(b) Other municipalities issuing their own paper in 1962 [illegible] Ottawa, Brantford, Vancouver, District of Burnaby, Greater

The policy provides for no distinction being made either on the basis of the impact of costs to the banks for different types of borrowers or the evaluation of the credit risk involved.

(j) The municipalities are long-established borrowers from the banks and the banks cannot claim that they do not know of their probable credit requirements; nor are they unaware of the consistently high record of municipal governments in fully discharging their bank credit obligations. Generally, municipalities supply their bank with a forecase of their credit requirements, usually before or at the beginning of each quarter of the year, and it is common practice at the end of each month for most municipalities to provide their bank (or banks) with a statement showing the actual banking position of the municipality in relation to the credit forecast. The banks have no better "credit" customers than the municipal governments.

Long-term Borrowing

(k) The most common instrument of financing is the serial bond, although the largest cities, and a number of smaller Quebec municipalities, sell term issues. The chief characteristic of serials is that the capital is repaid annually in instalments; the average period for which the initial debt is outstanding in a twenty-year serial issue is not much over ten years. Many economists argue that the municipalities are subjecting themselves to unnecessary strain in trying to finance projects with a life of twenty-five to fifty years on such a relatively short-term basis. The period over

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which serial bonds are repayable has increased somewhat lately and the average term has also been increased by the device of making the final instalment much larger than the others, but the serial bond remains a relatively short-term borrowing instrument.

(l) Serial bonds have been criticized by some investment dealers and institutional buyers. The chief criticism is the lack of marketability and liquidity of these bonds, both in new underwritings and in the secondary markets, which tend to hinder their sale to those institutions which are interested in bonds that can be readily sold if the market conditions change; and, since the number of institutional investment managers who take a trading view of bonds may be growing, the market for serial municipals may tend to contract. It is held, too, that the somewhat untidy form of serial issues makes them an unattractive investment. Not only are more actual certificates involved, but the aggregate investment is divided into small pieces and the annual repayment creates reinvestment problems.

(m) The view of municipalities about serial bonds has been influenced by the unfortunate experiences with sinking fund bonds and management during the 'thirties'. There is legitimate concern about the ability of many municipalities to manage their sinking funds properly and some provinces set such stringent regulations about the handling of sinking fund money that municipalities find it difficult to meet the conditions. For small municipalities the sinking fund approach to financing is almost impossible because of

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lack of the necessary financial management skills. Finally, serial bonds are the almost universal form of state and local debt instrument in the United States, and many Canadian municipal serial bonds find a market in that country.

(n) The obstacle to sinking fund issues might be overcome, for small or other municipalities, by the establishment of a centrally-managed sinking fund into which municipalities would pay their annual instalments.

J. FACTORS WHICH DETERMINE THE AMOUNTS, MATURITY AND TIMING OF SECURITY ISSUES

(1) The influence on municipal financing of federal and other government activity.

(a) In their approach to the bond market the municipalities (and the provinces) are in a different position from that of the Federal Government. Although the rates set by the market are essentially derived from the tightness or ease of credit conditions in the economy, the federal authorities can affect these conditions materially and can, to a considerable extent, manage the climate in which their borrowing is done. In contrast, other levels of government have little to say about the conditions under which they borrow apart from deciding to accelerate or postpone their borrowing for a brief period, or to borrow in the United States if that market is open to them.

(b) The inability of the municipalities to do anything about the market, in contrast to the dominant position of the Federal Government in it, is a disability of some consequence. During the period of the 1958 Conversion Loan and its aftermath municipalities took their capital where they could find it and paid whatever price they had to to get it. They increased their borrowing in the U.S. market substantially and, while this provided some escape from the high interest rates and difficult market conditions prevailing in Canada, the escape was bought at the risk of future exchange losses on interest and capital requirements.

(c) Borrowing by Canadian municipalities in the U.S.A. decreased greatly in 1960 and 1961.

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(c) Borrowing by Canadian municipalities

This was due in part to their growing awareness of the dangers inherent in debt payable in a foreign currency and, in part, to the withholding tax on U.S. pay issues imposed in December, 1960. A further factor was the improved market conditions in Canada which made borrowing easier. The June 1961 budget contributed to this and, in particular, the decision of the federal authorities to concentrate their borrowing in the short end and to use the purchase fund to support the long-term Canada market. However, the crisis in May and June 1962, and the federal reversion to long-term borrowing in July 1962 certainly affected adversely the attractiveness of the Canadian market for other borrowers.

(d) The influence of the Federal Government on the bond market, stems in part from its close relationship with the Bank of Canada. In its open market operations the Bank deals only in Government of Canada bonds.... The Bank of Canada Act, however, allows the Bank to buy and sell provincial securities and to make advances to chartered banks against the pledge of municipal bonds.

(e) The Federal Government has a larger arsenal of borrowing instruments to choose from than most borrowers, and municipalities have even fewer alternatives than the provinces to which they are subordinate. Their borrowing is mainly in the form of serial bonds, although some of the larger municipalities sell sinking fund term bonds maturing in about twenty to twenty-five years. As previously mentioned, there is a growing municipal trend towards using the resources

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of the short-term market by the sale of short-term notes. This is a form of instrument which only the larger municipalities are likely to be able to use effectively. Similarly, the U.S. market tends to be limited to the better known names and centres of larger population. However, the imposition of a withholding tax of 15 per cent in the December 1960 budget on foreign pay Canadian securities has made that market more expensive for Canadian borrowers.

(f) Any large scale provincial operation in the bond market has a definite effect upon the borrowing of municipal governments. The coupon rate decided upon by the provincial issues, the amount of the borrowing, whether it is a long or short-term security, and the length of the time which the public takes to absorb the issue, are factors which a municipality must take into account when considering the timing, terms and amount for its own debenture issue.

(g) It is more than coincidence that a flood of municipal issues tend to appear in the wake of a federal or provincial issue. But this is not the only reason why municipal issues seem to flock to the market together. Aa one municipal finance officer puts it: Timing is also largely a selling expedient and is influenced by such factors as (a) year-end inventory taking; (b) seasonal doldrums; (c) summer holidays; and other conditions.

(2) <u>Views as to the appropriate maturity structure of municipal debt and the merits of lengthening the average term of debt in view of the durability of certain municipal capital assets.</u>

(h) Opinion is divided among municipal administrators regarding the wisdom of lengthening the term of municipal borrowing for long-life municipal projects beyond the general practice of 20 years. Some feel that it would be difficult to market 30 to 40 year maturities.

(i) While the difference in annual cost between a 20 and 40 year amortization period is relatively small (about 2 per cent), nonetheless, the total cost of a 40 year amortization is about $2\frac{1}{2}$ times the amount borrowed compared to $1\frac{3}{4}$ times for a 20 year amortization.

(j) Some hold the extreme view that municipalities should strive to shorten their debt maturities to a maximum of 10 or even 5 years. Among this group are those who hold that, in principle, every generation should live with and finance its own problems and needs. Tbey argue that in this changing world there will be plenty of things for the next generation to take care of and they should not be prevented from doing so by a handicap of an old and undischarged debt.

(k) By contrast, there is a strong and growing feeling that costly municipal undertakings destined to serve the needs of several generations to come ought properly to be so financed that the burden of their costs is spread over a reasonable period beyond the present practice of from 10 to 20 years.

(l) In some municipalities where issues have been permitted to run from 15 to 40 years, the 40 year issues have been arranged on a 20 year term with provision for refunding at that maturity for a further 20 years.

This practice of permissible interim refunding may be justifiable when average interest rates prevail; but when borrowing requirements in the capital market reach the stage where an issue of debentures is needed once a year -- or oftener -- the refunding provision may ultimately result in some congestion if refunding has to be carried out at a time when annual requirements for new money are high.

K. METHODS OF ISSUE AND RELATIONSHIP TO THE INVESTMENT DEALER

(a) Municipalities sell their bonds by competitive tender or at a negotiated price through a fiscal agent, depending upon circumstances. The largest municipalities believe that they are almost forced by the size of their issues to use the agency approach since wide distribution of the securities requires a very large group of dealers. Other municipalities have stayed with competitive bidding, but the over-all trend has been in the direction of more fiscal agencies. A third approach has evolved which is a combination of the other two. A municipality can let it be known that it is considering a private placement of modest size and it invites subject bids for the whole issue from a few dealers with whom it has been negotiating. The dealers are given enough time to search out a few buyers who might be prepared to take all or most of the issue at a certain price, providing that the dealer is awarded the issue by the municipality. This system might be called "competitive private placement"; it is advantageous for both issuer and buyer because it is flexible and reduces under-writing costs.

(b) There are strong arguments in favour of competition bidding. The bonds sell at the best price the market will pay. The danger is that if the bidders are too competitive the price may be pushed up to an unreasonable level, resulting in a high priced issue that is difficult to sell and may be damaging to the future credit of the borrower. Moreover, no underwriter is permanently interested in the continuing saleability

of the borrower's issues and aftermarkets may suffer as a result. A fiscal agent can provide continuous advice on timing and methods of issuing bonds and, in general, be a consultant on financial matters. The fiscal agent may not pay quite as high a price as the issuer could obtain by calling for tenders, but he is likely to market the bonds in a more orderly fashion and will usually try to maintain active markets in the issuer's bonds. This helps to ensure that future issues can be sold at reasonable prices and rates. On the other hand, bad judgment on the part of the fiscal agent can be as damaging to the issuer's credit as an over-priced issue following a tender.

(c) The general practice in Canada is to pre-determine the coupon rate before marketing the issue. Tender is only on the price. The general practice in the U.S.A. is to leave the coupon rate open and let the bidders tender on the basis of the coupon rate and the price. Municipal bonds in the U.S.A. must be sold by competitive tender.

L. THE MARKET FOR MUNICIPAL BONDS

(a) The market for Canadian municipal bonds is largely institutional, although in some areas there is a good retail demand for local issuers. There are three principal categories of institutional buyers, not necessarily in the following order of importance:

(1) The chartered banks.

of the borrower's issues and aftermarkets may suffer as a result. A fiscal agent can provide continuous advice on timing and methods of issuing bonds and, in general, be a consultant on financial matters. The fiscal agent may not pay quite as high a price as the issuer could obtain by calling for tenders, but he is likely to market the bonds in a more orderly fashion and will usually try to maintain active markets in the issuer's bonds. This helps to ensure that future issues can be sold at reasonable prices and rates. On the other hand, bad judgment on the part of the fiscal agent can be as damaging to the issuer's credit as an over-priced issue following a tender.

(c) The general practice in Canada is to predetermine the coupon rate before marketing the issue. Tender is only on the price. The general practice in the U.S.A. is to leave the coupon rate open and let the bidders tender on the basis of the coupon rate and the price. Municipal bonds in the U.S.A. must be sold by competitive tender.

L. THE MARKET FOR MUNICIPAL BONDS

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(1) The chartered banks.

(2) Other Canadian institutions and corporations, including life insurance companies, trust and loan companies, pension funds, mutual funds, credit unions.

(3) Institutions in the United States and overseas.

(b) At the end of 1960 it was estimated by the Bank of Canada that about 75 per cent of outstanding municipal bonds wereheld by institutional and government accounts, a third of which were held by non-residents (28 per cent), almost all of whom were believed to be institutional holders. Banks, trust companies and credit unions (caisses populaires in Quebec) are the important institutional buyers of the shorter maturities and insurance and pension funds, both Canadian and American, of the longs. Between 1956 and 1960, approximately 27 per cent of the new issues of municipal bonds were payable in U.S. dollars or other foreign currencies, although before 1955 the proportion was much smaller. Since 1960, there has been a sharp decline in U.S. borrowing for a number of reasons which included official statements as to the dangers of heavy foreign commitment, the re-imposition of withholding taxes in the 1960 baby budget, relatively easier money conditions in 1961 and early 1962 and, until the June 1962 austerity crisis, a narrowing of the gap between Canadian and U.S. interest rates.

(c) In addition, any list of provincial and municipal bond buyers must include the sinking fund and

similar purchase funds of governments which are continually buying in or redeeming outstanding issues. These funds in their operations are not precisely comparable to ordinary buyers. Their purchases, however, have important market effects.

(d) Another group of buyers, in a somewhat similar category, are the investment dealers themselves who collectively at any one time will be increasing or decreasing their inventory of bonds. In respect of municipal bonds, however, their inventory accumulation has been largely involuntary.

(e) Most municipal finance administrators -- at any rate of the larger cities -- try to maintain a close relationship with institutional bond buyers. They recognize and appreciate that, in the aggregate, they constitute the largest group of investors in municipal bonds and that it is important that they be kept well informed with respect to the municipality's general financial affairs and with other community factors which affect the credit rating of a municipality and which, to a considerable extent, determines the amount of any individual municipality's bonds which institutional buyers will hold.

The Investment Practices and Holdings of Institutional Bond Buyers

Chartered Banks

(f) Banks have been important if intermittent buyers of municipal issues, usually taking bonds in the one to five year or one to ten year range. These purchases are frequently made because the bank is a member

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of the underwriting group involved in the new issues, or because it is the municipality's principal banker. However, the banks' total holdings of municipal bonds rose very little between the end of 1955 and 1961, from $218 million to $231 million. A moderate increase occurred in 1962, to $258 million at the end of June.

Life Insurance Companies

(g) Of other large institutional buyers of bonds in Canada, the life insurance companies rank first in importance. There have been profound post-war changes in the structure of life insurance company portfolios. Total Canadian bond holdings of the twelve large companies aggregated $2004 million in 1946 and, fifteen years later, had increased by less than 50 per cent. Over the same period the value of Government of Canada bonds held by these twelve companies fell by two-thirds, but provincial and municipal bond holdings more than tripled, and corporates rose steeply from $240 million to $1534 million. Between the end of 1959 and 1960, municipal holdings increased from $328 million to $547 million.

(h) The outstanding change in the life insurance companies' portfolios has been the rise in their mortgage holdings. A number of reasons are put forward to explain this, of which the most obvious one is the higher yields prevailing on mortgages throughout the post-war period. Another is that as mortgage portfolios increased the relative costs of administering them have been reduced steadily, from about 1.00 per cent per annum in 1951 to .42 per cent in 1960. Another reason appears to be

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connected with valuation procedures for the Department of Insurance; foreign companies operating in Canada are required to value their bond holdings at cost or market, whichever is lower, and the fluctuations in bond prices which have occurred have been severe enough at times to threaten the actuarial solvency of companies heavily invested in bonds. Mortgages are valued at cost and hence show no fluctuation; this adds to their appeal for the foreign companies.

(i) Although net annual purchases of bonds by the life companies have been only of the order of slightly more than $100 million a year in recent years -- perhaps only 7 or 8 per cent of the net increase in Canadian bonded debt -- the shifts in the portfolios and the large purchases of corporate issues continue to maintain the life companies' role as active and important participants in the market. Most of the companies have large investment departments, staffed by analysts and experts who appraise new issues from the point of view of quality, price and suitability for the company's portfolio. So important is the judgment of these experts in the sale of new issues that few issues are brought to market by dealers without prior consultation with the life companies and without an indication from at least some of them of an interest in it. If enough enthusiasm for the issue is exhibited in advance by the institutions, the underwriters may prefer to place the issue privately, particularly if it is small.

The Trust and Loan Companies

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(k) The pattern of a rising proportion of corporate bonds and mortgages is similar to that of the life insurance companies, although the trust companies have consistently placed more emphasis on Canadas, possibly because of their greater need for liquidity arising out of their deposit and certificate liabilities. Their portfolio structure may also be affected by the trustee acts of the various provinces in which the trust companies are located and which are similar to, but in some instances more restrictive than, the requirements of the Canada and British Insurance Companies Act. Those of New Brunswick appear particularly restrictive, for example the purchase of local municipal bonds only.

(l) The mortgage loan companies are usually grouped with the trust companies for purpose of analysis. As their name implies, their principal assets consist of mortgages, but they do hold some bonds, mainly Canadas, which again presumably are to provide liquidity against possible withdrawal of deposits. Total bond holdings increased from $58 million in 1951 to $104

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million in 1960.

Trusteed Pension Funds, Credit Unions and Mutual Funds

(m) Trusteed pension funds provide a very large market for bonds, particularly corporates, although these funds have been devoting an increasing proportion of their capital accretion in recent years in common stock and mortgages. As might be expected, the pension investments of the various governments are heavily weighted towards their own issues.

(n) Several pension funds have become active participants in the bond market in the past few years and, to some extent, carry out switching between issues. Most of the pension funds, however, have been growing so rapidly that the fund managers have been concerned more with the placing of new money than with the re-arrangement of the portfolio. Nevertheless at least one of the largest industrial pension funds in 1961 disposed of a substantial volume of discount Canadas, placing the proceeds in higher coupon Canadas, provincials, municipals and corporate bonds and in common stocks. These trading operations had a considerable market impact.

(o) The credit unions, including the caisses populaires in the Province of Quebec, held $279 million in "investments" at the end of 1960, up from $85 million in 1948 and $144 million in 1954. This category excludes mortgages, which are shown separately, and, presumably, consists mainly of bonds. The only available breakdown is that published by the caisses populaires, the assets of which constitute about 60 per cent of the total assets

of Canadian credit unions. At the end of 1960, the caisses held $212 million in bonds, including $24 million in Canadas, $35 million in provincials, $106 million in municipals and $47 million in religious issues.

Sales in Foreign Countries

(p) Non-residents form the third main group of buyers in the list and comprise mainly American insurance companies, pension funds and foundations. The Bank of Canada estimates that non-resident investors held $820 million in Government of Canada bonds at the end of 1961, or less than 5 per cent of the total outstanding. Their holdings of provincials, municipals and corporates aggregated some $5200 million, or close to 30 per cent of the gross amount of these bonds outstanding. There appears to be a good correlation over the years between non-resident holdings of provincials and municipals and foreign pay Canadian issues of these bonds and it is reasonable to conclude that most non-resident holdings of these bonds are of the foreign pay variety.

(q) The relative attractiveness of Canadian pay issues for American institutional investors is based upon a great many factors, psychological as well as material and, apart from pure yield considerations, varies according to each institution's tax surplus position, past experience with Canadian issues, general view of Canada and expectations about the future course of the exchange rate. The first test is that the bonds be "cheaper" than corresponding U.S. issues; establishing relative cheapness is not a simple matter because some assumptions have to be made about the exchange rate. Buyers in the

United States use a variety of tests to determine the spread in yield at which they consider Canadian internal bonds attractive compared to United States domestic bonds. Generally, an attempt is made to achieve a rate spread after allowing for differences in exchange which could yield a worthwhile increase in income and, at the same time, write in a reserve against exchange losses. When the Canadian dollar was substantially above par, some U.S. buyers used par as a basis for their calculations, with the general idea of providing themselves with some protection against a fall in the Canadian dollar. As the Canadian dollar fell in 1961 and 1962 the U.S. buyers tended to increase the size of their exchange reserve requirements.

(r) One problem the U.S. insurance company buyer faces is that bonds in foreign currencies must be revalued annually and any exchange losses written off immediately against surplus or other profits. This tends to make Canadian issues more attractive for well established U.S. insurance companies with large surpluses than for the new companies with less of a cushion against foreign exchange losses. Another problem is the withholding tax on Canadian pay issues and the extent to which the buyer can offset the tax against domestic income tax. The Canadian budget of December 1960, by increasing the withholding tax on Canada and provincial issues to the former lever of 15 per cent, and by imposing this tax on U.S. pay Canadian issues, did have a substantial dampening effect on sales of Canadian bonds in the United States.

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(s) Finally, Canadian bond sales in the United States may be affected by the changing image of Canada in the eyes of the U.S. buyer. Since the war Canada has generally been regarded as a well-managed country in which their funds were reasonably safe and it is questionable if Americans gave Canadian internal policies much thought for most of the period. In recent years, however, events and trends may have cautioned American buyers to doubly-weigh their Canadian investments. This was particularly noticeable in the spring and summer of 1962 when the U.S. buyers became increasingly suspicious of the continuing large budgetary deficits of the Federal Government. Their disenchantment with Canadian securities was intensified by the declining exchange value of the Canadian dollar, culminating in the balance of payments crisis in June, 1962. In summary, although the United States will probably continue to be an important source of funds for Canadian borrowers, the flow of bond capital northward may not move as freely as it has in recent years. Spreads in yield are less likely to be the primary determinant than the view Americans take of the stability of the Government and of its budgetary, monetary and exchange rate policies.

Sinking and Purchase Funds

(t) The bond holdings of provincial governments at the end of 1960, including provincial pension plans, sinking funds, hydro-electric commissions and workmen's compensation boards, were estimated by the Bank of Canada to be $2556 million at the end of 1960. Of this total, $1662 million were provincial bonds, $568 million Canadas,

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$286 million municipals and the remaining $39 million corporate and other. In effect, of a total gross-provincial direct and guaranteed debt of $6848 million at that date, nearly one-quarter was held by the provinces themselves in various accounts.

(u) The steady accumulation of their own bonds by the provinces has had important market effects. The fact that a province stands ready to buy back its own bonds at a price improves the market for its issues by mopping up speculative and distress selling. Furthermore, the knowledge that the buyer power is there -- if limited -- tends to prevent the distress selling that was so evident in the market for long-term Canada bonds in 1959 and 1960. Most of the provinces have statutory sinking funds ranging from 1 per cent to 3 per cent annually.

(v) The sinking or purchase fund can also be very useful in helping a new issue over the difficult launching period. In most issues there are some bonds which find their way into the hands of speculators or traders and into dealer inventory. These bonds are not "put away" but overhang the market and may threaten the success of the issue if any general market indigestion or weakness appears. By skimming off this floating supply, not necessarily at a profit to the speculators, the sinking fund (or any other similar fund the issuer cares to use) can prevent the isse from being a failure.

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M. FINANCIAL INVESTMENTS BY MUNICIPALITIES

(a) The major short-term investments of municipalities generally occur immediately in the wake of any tax payment period when large surplus sums of money become available to the municipality. These surplus funds are immediately invested in short-term securities pending the time when the funds are required for the normal expenditures of the municipality.

(b) The principal outlets for municipal short-term investments are:

(1) Treasury bills and other short-term Government securities.

(2) Bank-term deposits.

(3) Trust Company term deposits.

(4) U.S. Treasury bills.

(5) Commercial finance paper.

(c) Long-term investments are made for sinking fund requirements, municipal employees' pension funds and other similar municipal funds. These investments are, as a rule, restricted to trustee securities. In the case of employee pension funds, and similar municipally administered funds, some municipalities invest a part of the holdings in high-grade mortgages. Investments for sinking fund requirements are generally in securities that are readily marketable or timed to fit the maturity needs of each municipal fund.

A well-managed municipal portfolio will also take into consideration opportunities to increase the revenue earned on such investments by switching from low-yield securities to high-yield securities whenever this is possible.

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N. MUNICIPAL BORROWING IN THE UNITED STATES

(a) A difficult choice for municipalities, insofar as their capital borrowing is concerned, is the selection of the market to approach for funds. For many municipalities -- particularly the larger ones but not necessarily confined to them -- the basic decision is whether to borrow in Canada or to test the U.S. market. If the borrowing is done in the United States, the form it takes will, in most instances, be along conventional lines, that is, serial or long-term bonds.

(b) The decision to go to the United States makret will depend essentially on the following factors:

(1) The availability of money in Canada.

(2) The spread in interest rates between the two countries.

(3) The exchange rate at which the transaction is to be carried out.

(4) The prospective future cost of purchasing United States dollars for debt service.

(5) The Federal Government's attitude towards foreign borrowing.

(c) Most municipalities prefer to borrow in the Canadian market if money is available at reasonable rates. They are mindful that borrowing in foreign funds involves the risk of exchange rate fluctuations and, moreover, in calculating relative borrowing costs assumptions have to be made about the unpredictable future value of the Canadian dollar in U.S. terms.

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borrowing can be subsequently offset by a fall in the exchange rate. For example, those municipalities which in 1959 were forced into the U.S. market because of the tightness of money and high interest rates in Canada converted the proceeds of their U.S. loans when the Canadian dollar averaged $1.04 U.S. Subsequently, the cost of servicing such loans has risen by over 10 per cent. As a consequence, current exchange costs have effectively offset any interest rates saving at the time of issue. However, the net gain or loss can only be measured by averaging the exchange rate over the life of the issue and including the cost of the U.S. funds when the bonds are redeemed.... An official of one municipality which borrowed in the United States in July 1962 has estimated that the City would be ahead if the average value of the Canadian dollar over the life of the issue remained above eighty-six cents U.S.

(e) In spite of the exchange rate problem, most municipalities feel that it is a sound and sensible policy to borrow at least occasionally in the United States. There are times, such as in 1959, when borrowing in Canada is very difficult if not impossible. In such circumstances the U.S. market provides a useful emergency source of money. Moreover, even if the borrowing can all be done in Canada, a U.S. issue relieves pressure on the Canadian market for the issuer's bonds and may, thereby, make it possible to sell a subsequent Canadian issue on a lower yield basis.

(f) The extent of municipal borrowing abroad over the period 1954 to 1961 (mainly in the United

States) is shown in the following table:

PROCEEDS OF NEW ISSUES OF CANADIAN MUNICIPAL BONDS AND DEBENTURES SOLD TO NON-RESIDENTS (1)

(In Millions of Dollars)

	1954	1955	1956	1957	1958	1959	1960	1961
Payable in Canadian Currency	11	4	6	8	5	10	16	7
Payable in Foreign Currency	34	40	105	115	143	148	119 (2)	28
TOTAL	45	44	112	123	148	158	135	36
By Comparision, the total of all new issues of bonds and debentures, both government and corporate, sold to non-residents in these years was:	312	103	597	737	634	660	421	456

Comparative Costs of American and Canadian Municipal Borrowing

(g) The interest cost for Canadian municipal bonds is substantially greater than that of municipalities in the U.S.A. due, in part, to the fact that income from municipal and state bonds in the United States is free of income tax.

According to Gordon L. Calvert, Municipal Director, Investment Bankers Association of America, this freedom from the federal income tax is based on recognition by the U.S. Supreme Court of the constitutional doctrine

(1) D.B.S.: Sales and Purchases of securities between Canada and other countries Dec. 1961 and Review of Security Trading during 1961.

(2) In 1960, the City of Quebec floated an issue in Switzerland of $4.5 million with an interest rate of 4½ per cent payable in Swiss francs. (18 year loan repayable in seven annual payments commencing in 1972).

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> "It is contended that although the property or revenues of the states or their instrumentalities cannot be taxed, nevertheless the income derived from states, county and municipal securities can be taxed. But we think the same want of power to tax the property or revenues of the states or their instrumentalities exists in relation to a tax on the income from their securities and, for the same reason, it is obvious that taxation on the interest therefrom would operate on the power to borrow before it is exercised and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the states and their instrumentalities to borrow money and, consequently, repugnant to the Constitution."

(h) In later years litigation continued because of the growing importance of the income tax as a source of revenue. Since many tax-exempt bonds end up in the portfolios of those in the highest tax brackets, the

(1) "Fundamentals of Municipal Bonds" (By Gordon L. Calvert) published by Investment Bankers Association of America.

of "reciprocal immunity"[1]. There have been a long series of court cases on this question. One of the earliest and most relevant is the 1895 judgment. "Pollock vs Farmers Loan & Trust Co. 157 U.S. 429" which is referred to by Mr. Calvert. He quotes the Supreme Court as stating in this case:

"It is contended that although the property or revenues of the states or their instrumentalities cannot be taxed, nevertheless the income derived from states, county and municipal securities can be taxed. But we think the same want of power to tax the property or revenues of the states or their instrumentalities exists in relation to a tax on the income from their securities and, for the same reason, it is obvious that taxation on the interest therefrom would operate on the power to borrow before it is exercised and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the states and their instrumentalities to borrow money and, consequently, repugnant to the Constitution."

(7) In later years litigation continued because of the growing importance of the income tax as a source of revenue. Since many tax-exempt bonds end up in the portfolios of those in the highest tax brackets, the

(1) "Fundamentals of Municipal Bonds" (By Gordon L. Calvert) published by Investment Bankers Association of America.

exemption provides a loophole of increasing concern to the federal authorities. However, opposition to removing the exemption has remained strong because of the fear that its abrogation would lead to federal domination and control of the states. As Mr. Calvert noted:

> "The tax exemption for interest on municipal bonds is essential to state and local government, not only to obtain a much lower rate of interest on these bonds than would be obtained without such tax exemption but, more basically, to protect their independent sovereignty under our dual state-federal system of government."

(i) How much lower rates the U.S. states and local governments obtain from tax-exemption of their bond issues is difficult to calculate, but the following information taken from the Wall Street Journal of March 1, 1962, provides some idea of the level of U.S. state and municipal yields:

Issuer	Size & Form of Issue			Cost to Borrower of Selling Price	
Tennessee	$12.3 million	serials	1963-82	1.65% to 3.10%	- Av.2.96%
Massachusetts	$40.0	" "	1963-82	1.70% to 3.20%	- Av.3.05%
Rhode Island	$ 4.3	" "	1963-92	1.70% to 3.45%	-
City of Columbus,Ga.	$ 3.5	" "	1963-91	1.80% to 3.55%	-
Prince George County, Md.	$11.5	" "	1963-85	1.75% to 3.40%	-
Orleans Parish, La.	$10.0	" "	1962-2001	1.50% to 3.70%	-Av.3.55%

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(j) The average yield on the twenty-year maturities in the above list was about 3.25 per cent (which was clos

to a three-year low on tax-exempt yields). On the same day U.S. Treasuries of equivalent term were selling at about a 4.00 basis and new issues of twenty-year and thirty-year private utility bonds were offered slightly under a 4.50 basis. In Canada, top-grade provincials would sell on a yield basis between Canadas and utility issues, best quality municipals on about the same basis as utility bonds and lower grade municipal bonds at 25 to 50 basis points above utilities or about 1.00 per cent above Canadas.

(k) It would be reasonable to assume from these figures that if the same good market for tax-exempt bonds existed in Canada as in the UnitedStates, the saving to provinces and municipalities from exemption of their bonds from income tax would be a minimum of 1 per cent on the coupon and, possibly, 1½ or more, given the higher yield structure in Canada.

(l) The assumption about markets, however, needs careful examination. Proportionately there is a much greater concentration of wealthy people in the United States than in Canada and it is questionable if the demand from individuals in Canada for tax-exempts would provide anything like the amount of capital that provinces and municipalities borrow annually. The demand would be strong for short-term tax-exempt bonds from corporate investors because many short-term instruments now are tailored to fit accounts paying 50 per cent income tax, but for many institutional buyers of long-term bond issues tax considerations are not important.

(m) It would be interesting to see how much Canadian private capital now employed in various tax avoidance schemes could be tempted into tax-exempt provincial or municipal bonds. There is no obvious reasons why this form of assistance, with all its unhappy political connotations of tax evasion, should be preferred to any other form of federal assistance to junior governments. In defence of the principle, however, is the fact that the U.S. system recognizes clearly that state and local governments have a right to some financial independence from Washington. In their borrowing, Canadian municipalities and provinces are at the mercy of a market in which conditions are greatly affected by fiscal, monetary and debt management policies set by the Federal Government and from which there is no court of appeal.

O. LIMITATIONS OF MUNICIPAL FINANCING RESULTING FROM FEDERAL TAX PRACTICES

1. Comparison between Municipal and Corporate Borrowers

(a) In comparing their position with corporate borrowers, the municipalities (and, presumably, the provinces) feel that they merit special consideration by the Federal Government. Interest on corporate bonds is a cost of doing business and a deduction from income before taxes. A corporation therefore tends to regard the coupon of a bond as half chargeable against income tax. While it is technically incorrect to argue that corporate borrowing is actually subsidized

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by the federal treasury, the effect is somewhat similar and tends to tilt corporations towards bond issues rather than equity financing. This, in turn, increases the pressure on the market generally and may raise costs for other borrowers.

(b) In addition, there is some feeling that the dividend tax credit on stocks has made the purchase of them for the individual so attractive that bonds have lost their attractiveness for the individual investor. This has made all bonds more difficult to sell and raised interest rates. While the argument in favour of reducing doublt taxation on common stock has some weight, there is less justification for a tax deduction on preferreds and this, in effect, represents an additional government subsidy for an instrument that competes with bonds in the capital market....

In this connection, it is interesting to note that in Australia a 10 per cent tax credit is granted on interest on Commonwealth and State bonds, applicable to both personal or corporate income.

2. <u>Property Tax Exemption and Double Taxation</u>

(c) In the application of the property-tax, Canadian municipalities (compared to those of the U.S.A. and several other countries) suffer a severe limitation arising from a feature of our federal income tax legislation. In effect, Canadian property owners are subject to double taxation on that portion of their income used to pay municipal and provincial taxes. In the United States, all payments made on state or municipal taxes may be deducted from personal income

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in computing taxable income. The principle on which this is based is, in part, the theory of "reciprocal immunity" cited earlier, but also that, without such exemption, the property owner is subject to double taxation.

(d) It is only by allowing such an exemption that municipalities can be given full use of the property tax field. A simple calculation will show that, by allowing deduction of municipal taxes from income, the Federal Government would enable municipalities to raise a substantially greater revenue from the property tax. Inasmuch as, in theory, our national policy intends the property tax to be fully at the disposal of the municipality, there appears to be no justification for the severe attenuation of that field of taxation which results from the present federal taxation of the personal income used to pay municipal taxes.

(e) Another severe handicap for Canadian municipalities (in comparison with municipalities in the U.S. and the U.K.) is the federal taxation of that portion of personal income used to pay mortgage interest on owner-occuped homes. Where such interest is deductible, from income for tax purposes, higher municipal revenue from taxes is possible.

(f) It should also be noted that such taxes and interest are deductible by corporations or individuals who hold property for business or income purposes and, in this respect, are similar to interest paid on borrowed money.

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should study this question of the several handicaps to municipal financing resulting from federal tax practices and make recommendations to the Federal Government.

P. FUTURE MUNICIPAL CAPITAL REQUIREMENTS

(a) The capital expenditures of municipal governments -- in these days -- embrace more than their traditional responsibility for the installation of local improvements and the provision of community institutions such as schools, hospitals, library, park and recreational facilities.... Above and beyond the "social" facilities and institutions -- normally required by the residential population -- are the "economic" facilities arising from the particular and growing requirements of commerce and industry.... As at no previous time, municipal governments are being called upon to provide costly installations (urban highways and expressways, mass transit facilities, water and sewage facilities, etc.) essential to the "economic" as well as the "social" activities of our expanding urban communities.

(b) To take full account of municipal needs for capital expenditures it is necessary therefore to think of the municipality as a unit of government responsible not only for the "social" needs of its citizens but also for those basic and costly "economic" needs which, under modern conditions, are properly the responsibility of municipal governments, to provide even though such needs

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are generated, in large part, by "users" whose plant or operating facilities -- or places of residence -- are located beyond the corporate limits of the providing municipality.... In effect, municipal governments -- particularly the larger metropolitan cities -- are called upon to provide costly installations, the benefit of which accrues to non-resident and, therefore, non-tax paying users.

(c) Some idea of the looming capital needs of municipal governments was indicated in the forecast made by the Royal Commission on Canada's Economic Prospects. These calculations, published in November 1957, were related to what were described as requirements for "housing and social capital". While the requirements included estimated capital expenditures on roads and streets (the largest single item in the estimated forecase) no provision was made for mass transit and commuter railway facilities. Nor was there any apparent inclusion for the municipal costs of urban re-development.

(d) Despite these omissions, the Commission estimated that by 1980 social capital expenditures will be required in Canada to the amount of $19.5 billion for roads and streets; $4.2 billion for schools and universities; $2.7 billion for hospitals; $2.7 billion for sewerage systems; and $2.4 billion for waterworks. The total estimate of capital expenditures <u>on these items alone</u> amounts to $31.5 billion.... The greater part of these expenditures will devolve upon the municipal governments.

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then, by 1980, the aggregate municipal debt in Canada for these purposes will have soared from its present approximate $4 billion to a figure somewhere in the range of $20/25 billion. Even if it is only half this figure, it will be a staggering amount. The more so when it is remembered that $3 billion (or more) of the present $4 billion municipal debt load has occurred over a twelve-year period; an average rate of $250 million a year.

(f) Assuming that municipal borrowing requirements in the next eighteen years (by 1980) will be one quarter of that estimated by the Royal Commission on Canada's Economic Prospects, say, $8 billion, then the average annual capital borrowing requirements of municipal governments between now and 1980 will be somewhere in the range of $500 million -- twice the amount of their average annual borrowing since 1950. This may be a high or a low estimate, but, whatever the actual figure may be, certainly it will be one of considerably greater magnitude than has typified municipal capital expenditures during the past decade.

(g) The magnitude and urgency of local government or "social capital" needs was also stressed in the more recent report (June 1961) of the Special Senate Committee on Manpower and Employment. The reasons were stated by the Senate Committee as follows:

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"The maintenance of an adequate rate of economic growth requires a continuing high level of capital investment, both private and public. Private capital investment

must be supplemented and stimulated by an adequate rate of government investment in social capital. Our stock of social capital is both inadequate and, in many respects, obsolescent, especially in our rapidly expanding urban areas. We are in a continuing danger of choking our economic growth with congestion, pollution, the development of slums, and with the effects of deficiencies in vital public services and amenities. The bottlenecks appear to lie in the methods of financing, in lack of planning and in the difficulties of achieving effective co-operation between the three levels of government. The solution of these problems requires new thinking, experimentation and the development of new machinery for financing, planning and inter-governmental co-operation. The initiative taken recently by the Federal Government to encourage a more adequate provision of sewerage facilities is an example of what is needed. The scale of capital financing required in the future for municipal works is so large that a new measure of responsibility is required in the raising of such funds on the part of the provincial and federal governments. Here, perhaps, is the basis on which a solution to the other problems of better planning and the development of better machinery for co-operation might, also, be sought." (1)

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(h) The need to go beyond monetary and fiscal measures -- to recognize that priorities must be established in deciding the nation's investment policy and that this involves a qualitative appraisal of objectives -- is clearly implied in the two reports mentioned.... Wasteful and unproductive investment or "choking our economic growth with congestion, pollution, the development of slums, and with the effects of deficiencies in vital public services and amenities" -- these, as well as flaws in tax or monetary policy, are inimical to a sound Canadian economy. The Royal Commission on Canada's Economic Prospects concluded its chapter on "Housing and Social Capital" by pointing out that

> "the real problem to be faced by Canadians in this field is not going to be one of fundamental inability to pay. It will be, rather, one of deciding what proportion of a growing national income should be devoted to the building of those things which only the community can provide and of developing the best possible fiscal and administrative arrangements to make that decision effective..."

The Need for a National Municipal Borrowing Programme

(i) It is in this context that we see the necessity for an effective partnership between all levels of government for the purpose of providing and facilitating the capital borrowing needs of municipal governments in the period ahead.

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physical inter-relationship between housing, urban transportation, harbour and airport facilities, federal and provincial works, municipal utility services, water conservation and the provision of recreational space for a rapidly increasing urban population. All such facilities are inter-related parts of the physical development which constitutes a new or re-developed city (or region). No part can be considered in isolation from the others. Each is an essential segment of the urban pattern which must, for the purpose of design and financing, be seen as a whole.

(k) Another reason why joint responsibility is essential is that the burden of cost which community growth and development imposes upon all levels of government is so great as to require the closest possible collaboration between them: first, in the programming of such works and, second, in the mobilizing of capital for the entire programme.

(l) In recent federal legislation (allowing federal loans for long-terms based on the federal government's borrowing rate) and in the urben renewal legislation (allowing a direct federal investment of 50 per cent of the cost of acquiring and clearing land for re-development) the federal government has taken important steps toward assisting in investment in essential community development.[1]

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of borrowing for basic community facilities. The eagerness of the local governments in taking advantage of the direct long-term sewer financing is convincing evidence that their need -- as far as basic municipal works are concerned -- is for federal assistance in arranging the capital financing of such projects.

(n) They require such assistance because of the handicaps under which they operate insofar as capital borrowing is concerned. These handicaps arise, at least in part, from the fact that the magnitude of municipal borrowing needs -- in these times -- has strained the limitations dictated by a municipal tax revenue structure which was never conceived to meet capital needs of these proportions.

(o) It is not that our urban communities are poor. There are some exceptions: [1] but, in the main, the productive wealth of the nation is concentrated in them and is continuing to increase. Most of this wealth, however, is already pre-empted for tax purposes by the senior governments so that municipal governments have no access to it. As a consequence, municipalities are unable to command sufficient income from the total taxable wealth resources of the community to support the growing burden of costs involved in undertaking the community improvements which are needed.

(p) A further consideration affecting municipal improvement programmes is that the ability of municipal governments to borrow is by no means uniform throughout the country. The larger municipalities are in the most preferred position, although even they have their

[1] The exceptions are those communities in various parts of the country whose economic base is withering away and for whom special re-development measures have become imperative

difficulties. The smaller municipalities are in the worst position. It is frequently difficult to market the debentures of a smaller municipality and, at times, there is no market receptivity for such issues at all.

(q) Moreover, during recurrent periods in recent years, the capital market for municipal bonds has tightened considerably. Because of the general shortgage of capital investment funds the market has been more selective with interest rates reflecting the competition of both private and public borrowers for a share of the limited supply. The cost of borrowing has soared to the point where in 1961 new municipal bond issues of even high-rated municipalities were being offered at a yield price of 6.30 per cent to 6.35 per cent,with the yield price of smaller municipalities being offered at as much as 7.75 per cent.

(r) While effective yield prices of 6 to 7 per cent and more may not present any grave financing problem to private borrowers who require capital for productive business and industrial purposes, the same cannot be said for municipal governments whose capital borrowings are used, in the main, for socially useful community improvements.... As shown by the following table, every percentage point increase in the costs of municipal borrowing adds substantially to the over-all debt carrying charges which the municipality has obligated itself to repay.

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Amount	Annual Cost Factor
$1 million for 20 years at 5%	$ 80,242.59
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Q. NATIONAL MUNICIPAL LOAN FUND

(a) The recurrent major fact which emerges from this submission is that municipal governments are experiencing difficulty with respect to their capital borrowing requirements. The difficulty is becoming increasingly acute and, in the view of the Federation -- speaking for the municipal governments of Canada -- there are good and sufficient reasons why the Federal Government, in co-operation with the provinces, should establish a National Municipal Loan Fund for the purpose of facilitating the capital borrowing needs of municipal governments.

(b) There is nothing novel about the principle of this proposal. Municipal loan agencies of this sort have existed in Europe since before the turn of the century. The "Credit Communal" of Belgium was formed in 1860 and has been operating successfully ever since. Similar banks or institutions are in existence in the Netherlands, Spain, Denmark, Norway, Italy, Switzerland, Israel and Turkey; and in the United Kingdom the Public Works Loan Board is in effect a municipal loan bank.[1]

(c) A National Municipal Loan Fund or Municipal Development Bank (the name is less important than the purpose of the agency) could be established by the Federal Government with the concurrence and co-operation of the provinces. In order to assure the constitutional position of the provincial governments, loans to any municipality would require the final approval of the province in which the borrowing municipality is located.

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(1) See Appendix to the Brief: "National Institutions for Municipal Credit".

(d) The creation of such a federally-initiated municipal loan fund would relieve municipalities from exposure to some of the vagaries of the market and would reduce their borrowing costs. Federal financial assistance to municipalities has been increasing in recent years and has taken the form of grants for hospitals, vocational and technical schools, housing and sewer projects. The purpose of the loan fund would be to maintain and extend federal financial participation in such durable municipal work requirements. While the Bank would be a new form of intervention, it would be a way of acknowledging that municipalities do have special financing difficulties and would be a useful vehicle for channelling to the municipalities any assistance that federal or provincial authorities might provide to reduce municipal borrowing costs. Its primary purpose, however, would be to marshal the capital funds required by municipal governments and make such funds available to the municipalities.

(e) A possible source of federal funds to enable municipalities to obtain their borrowings at a cost lower than the market rate would be to apply the federal revenues received from the taxation of interest on municipal bonds to municipal loans contracted through the proposes loan agency.

(f) As the municipalities see it, the proposed agency would issue its own securities with a federal guarantee and use the resulting funds for loans to municipal governments at interest rates comparable to those obtained by the Federal Government (less the proposed municipal interest tax subsidy) and thereby make it feasible for any

municipality, large or small, to finance the cost of municipal capital works.

(g) In effect, the municipalities are saying that, in their importance as basic community needs, municipal capital works are of equal priority with those of the senior governments. It would, therefore, be fair and equitable to enable municipal governments to have the same advantages as senior governments in respect to the capital market.

(h) The establishment of such a fund would not preclude municipalities from seeking capital funds elsewhere; but it would offer an alternative source of funds at more reasonable rates of interest than those now available to all but a few of the larger and better rated municipalities. Moreover, it would have the desirable effect of maintaining a reasonable flow of capital funds to municipal governments during a period of tight money pressure; and, during a recession, could be a buffer against the tendency of the market to shy away from municipal bond borrowing.

(i) Another purpose which a national municipal lending agency would serve would be to facilitate borrowing within Canada for Canadian needs. It would therefore be a positive means of implementing the federal government's policy of encouraging reliance upon domestic savings.

(j) For three impelling reasons, therefore, a Municipal Development Bank is a missing link:

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(1) in upgrading municipal capital requirements to the equal status which they deserve with

those of the federal and provincial governments;

(2) in facilitating -- for the purpose of assusing soundly based national growth and development -- the constant review and co-ordination of public investments; and

(3) in implementing, to the advantage of the entire national economy, the policy of drawing to the utmost upon Canadian savings for our capital investments.

(k) The Federation feels that the equalization of the capital needs of municipal governments -- in their approach to the capital market -- will be in the interest of all governments concerned and will be a major step forward in the common effort toward national growth and stability.

(l) The introduction of such inter-governmental co-operation in borrowing would further strengthen democratic governments at the local level. The municipalities would retain the initiative -- and would indeed be in a better position than now to exercise the initiative -- in the planning and execution of comprehensive programmes of capital works. Already more and more of our local governments are preparing long-term capital works budgets based upon carefully considered programmes of physical development. Their principal concern is whether they can finance such undertakings and at what cost. The establishment of a national municipal lending agency, by removing one

of the most frustrating obstacles to municipal development, would give a sharp incentive to the forward planning of growth and re-development. It would help greatly to keep constantly before each urban area a planned capital development programme which would not only provide work but would direct such work to the satisfaction of basic community needs.

(m) This reliance in a democratic manner upon municipal initiative is important. For it is only at the level of the local community that a balanced programme representing the needs and desires of local citizens can be developed. Even a large proportion of Federal and Provincial works (such as roads), bridges, harbour installations, airports and office buildings) must fit into a workable community programme in the interest of all concerned.

(n) Municipal responsibility for such programming must therefore be acknowledged and must of course be fully exercised by the municipalities themselves if they are to take advantage of a more favourable relationship to the capital market which a federal lending agency would make possible.

(o) The municipal governments contend that there is a strong and clearly defined need to establish such a National Municipal loan agency in Canada and that it is in the national interest to do so. Since the proposal was first put forward there has been a growing body of informed support in favour of the proposal. Certainly, so far as the municipal governments are concerned, it would enable them to initiate and carry through needed

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programmes of local improvements and re-development for which the urgency is now very considerable and which in many municipalities, without such a facilitating loan agency, are likely to be indefinitely delayed.

APPENDIX "A"

NATIONAL INSTITUTIONS IN EUROPE FOR MUNICIPAL CREDIT

FOREWORD

The structure and responsibilities of local governments in different countries varies widely. Consequently, it is difficult -- if not impossible -- to compare their comparative needs for credit and long-term capital funds....

Moreover, the borrowing requirements of local governments in different stages of economic development, expressed in terms of needs (justified by the financial capacity of the citizens and the community concerned), are always greater than the resources for carrying them into effect (viz., capital, labour, etc.). As a consequence, the provision of credit to local authorities in Europe has developed differently in the different countries depending on the conditions in each country....

In 1954, the International Union of Local Authorities (1) undertook a comprehensive study of the existing facilities for municipal credit in different countries and, at its 1955 Rome Congress, the problem of municipal borrowing was a major item under discussion. The general position taken by the Congress with respect to the matter was summed up in the following resolution:

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"Appropriate bodies should be set up in each country where they do not already exist in order to resolve the difficulties met with today in finding the funds to implement local authorities programmes. The specific and sole aim of these bodies should be to hold credit for the use of local authorities and they should be assured of adequate funds up to the limit that can be permitted by the respective national economies."

A similar position to the Rome I.U.L.A. recommendation was subsequently adopted by the Consultative Assembly of the Council of Europe which went on record as favouring the foundation of a European Bank for Municipal Credit.

The idea of a European Bank for local authorities is ambitious and suited to the ideal of an integrated Europe. Its successful organization, however, will depend on many factors, such as the idea of integration catching on and the practical development of that integration. Meanwhile, the proposal has provoked intensive study and it is quite probable that sometime in the future a European Bank for local authorities will be realized.

Already there exists in European countries a number of financial institutions that were founded with the sole objective of meeting the credit requirements of local governments.... Despite differences in structure and business procedure (which originate chiefly from differences in the structure of local

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Already there exists in European countries a number of financial institutions that were founded with the sole objective of meeting the credit requirements of local governments.... Despite differences in structure and business procedure (which originate chiefly from differences in the structure of local

government and of the money and capital market) two main types of municipal credit banks in Europe can be distinguished; (a) the co-operative type formed by local authorities, and (b) the State Municipal Bank. In between there are banks that belong -- as it were -- to an intermediate group and where private participation also plays its part. Where national municipal credit institutions have been established it is generally recognized that a certain degree of State supervision is called for in as much as a national credit institution for municipal governments can, by its conduct of affairs, often exert considerable influence, firstly, on the capital market, in which the State is also generally a heavy buyer, and, secondly, on the public welfare level of the population as a whole.

Some of the general grounds put forward by European local authorities for the establishment of a central municipal development bank can be summarized somewhat as follows:

(a) As a rule municipal governments do not dispose of all of their ordinary revenue as soon as it has come in.

(b) There exists, therefore, a certain time lag between the receiving and the spending of municipal revenues.

(c) The centralizing of these temporary surpluses creates a basis for the granting of short-term credits to other local authorities which are temporarily in need of funds pending the receipt of ordinary

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or other revenue.

(d) This means interest earnings for the central bank which enables it to pay interest on the funds deposited with it by surplus local authorities.

(e) Through the facilities of a municipal credit bank there thus can be realized a mutual assistance between local authorities as regards short-term credits by making interest earning investments.

(f) The credit potential of a municipal credit bank can be strengthened very much if all payments of the senior governments to the local authority (grants, loan payments, municipal share in state taxes, etc.) are accomplished by payments into the account which local authorities have with the bank and if all, or most of them, left the money deposited there until such time as actual payments are required.

(g) Such a policy would strengthen the short-term credit position of local governments, strengthen the financial capacity of the credit bank and make for a flexible and well organized transfer of payments.

The experience of European countries having municipal credit banks indicates that the specialization of a single institution, insofar as the borrowing and particularly the long-term loan requirements of

municipal governments are concerned, accrues to the benefit of local authorities and leads to a more powerful position on the capital market in several respects:

(a) Instead of lending relatively small amounts of money to a variety of local authorities -- whose credit worthiness perhaps has to be examined individually -- investors can lend much larger sums to an institution, the credit worthiness of which can be judged without any special know-how (the know-how is vested in the nature of the institution) about the credit worthiness applicable to the local governments on whose behalf it borrows.

(b) A specialized lending institution is in a much better position to make use of all the opportunities the capital market has to offer than can the individual local authority.

(c) A specialized institution is in a better position also to influence the ruling modalities on the capital market as to the needs and desires of the local authorities.

European municipal credit banks (or institutions) operate in both non-federated and federates states.... Historically, many European countries are federal in character and have three levels of government: National, Provincial (or State) and Municipal. The nature of the

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The following pages provide a general description of some of the national municipal credit institutions in European countries (as well as in some others); and, where no such institution exists, of the sources and methods whereby local governments obtain their credit and capital borrowing requirements.

BELGIUM

The"Credit Communal" of Belgium was founded in 1860.

Prior to that time small municipalities were experiencing great difficulty in obtaining loans for municipal improvements. As a rule, the only source available to them were the private banks and financial institutions and, on occasion, private individuals. Under these circumstances municipal loans were obtained under rather onerous conditions. Only the larger cities were able to issue their own securities and obtain capital funds at reasonable rates.

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"communes" of Belgium found it virtually impossible to obtain loans for their required municipal improvements.

Towards the middle of the last century several studies were made in an endeavour to solve the problem. The matter was taken in hand by the National Government and the then Minister of Finance summarized the alternatives as follows:

(a) either the National Government would have to intervene and provide loan funds direct to municipalities which would mean some loss of municipal autonomy in as much as the State would be responsible for the municipal loans; or

(b) a private institution might be established, the function of which would be to raise loans for municipalities with any profit from its operations accruing to the shareholders of the company.

The Minister made it clear that what he had in mind was the creation of an institution or private company which would operate within well established business and financial methods.

Out of this background there emerged the idea of creating a company, the shareholders of which would be borrowing local authorities, with the annual profits being distributed between them without any intervention from the Government. It was on this basis that the "Credit Communal" was founded as a limited liability company for a duration of 99 years.... This is still the

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case, although the statute rules of the company are somewhat different from private limited liability companies.

The "Credit Communal" was the first co-operative association of local governments in the world. Economists such as Bernard Lavergne (a Frenchman) have assigned to this historic event the same importance as is ascribed to the creation of the first consumer co-operative society, "The Equitable Pioneers of Rochdale".

The most important problem which the "Credit Communal" had to surmount at its inception was the matter of the guarantees of municipal loans. This was solved as follows: in 1860 some of the local taxes prevailing in the cities and towns of Belgium were abolished. These were replaced by a Central Fund ("Fonds communal") which was derived from State imposed taxes and distributed each year between the municipalities. It was agreed that the "communes" would be allowed to turn over to the "Credit Communal" their part of the State collected taxes as a guarantee for the loans concluded by the "Credit Communal". Even today the contributions provided by the State authorities to local authorities are the principal warrant for the capital funds which local authorities borrow from the "Credit Communal".

As indicated, the "Credit Communal" is owned by the local authorities, their share capital consisting of part of the consolidated long-term loans which the "Credit Communal" has made to local authorities. These loans are repayable by equal ammunities. Originally, 5

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The management of the company consists of a General Assembly which is composed of all the municipal shareholders represented either by their mayor, alderman, or a local councillor. A Board of Directors, which is appointed by the General Assembly, administers the company who, in turn, appoints a Supervisory Committee for the general oversight of all the operations of the company, including the loans made to local authorities. The Board of Directors consists of nine members elected for six years. The "Credit Communal" now makes loans to provinces, municipalities, joint boards of local authorities and to some other local organizations, such as public assistance boards. The "Credit Communal" issues the following types of credits:

1. Long-term Credits

(a) Consolidated Loans:

This type of loan credit has now been abandoned. Under it, the loan requirements of several municipalities were grouped and consolidated in one loan issue. The amounts obtained therefrom by each of the several municipalities were repayable in annuities,

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As indicated, the capital required was obtained by long-term issues and distributed between the cities which had requested the loan. The rate fixed for the duration of the loan included all the issue and administration costs. As this kind of capital borrowing was only possible when the "Credit Communal" could issue bonds of at least 30 years, the consolidated loans were abandoned after the second World War when it became impossible to issue bonds in Belgium for more than five years (and in exceptional cases ten years).

(b) Non-consolidated Loans:

Since 1948, loans granted by the "Credit Communal" to local authorities are repayable by annual amounts with a variable rate of interest. The rate is fixed twice a year, in June and in December. It is impossible to fix the rate for the whole duration of the loan as the capital funds are now provided by issues of short and medium-term bonds (1, 2, 3, 5 and 10 years) which, at their expiration, have to be replaced by new bonds, the rate of which may differ considerably

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from the old ones. It therefore follows that local authorities, when including such loans, do not know at the time when the loan is concluded what the rate will be over its duration.... As a rule, it has always been lower than the public market rates. This is due principally to the co-operative character of the company.

As pointed out, there is no subscription of share capital required from the local authority when non-consolidated loans are concluded.

From 1948 to 1953 the long-term loans of the "Credit Communal" ranged from 20 to 30 years; in 1953, the maximum duration was reduced to 20 years, in as much as at that time the issue of long-term bonds was not readily acceptable in the money market.

2. Medium-term Loans

These loans range from 5 to 10 years (exceptionally for 15 years). The procedure in obtaining the loan is the same as for the non-consolidated long-term credit.

3. Short-term Credits

(a) For extraordinary Expenses:

Loans under this heading would cover the borrowing needs of local authorities for unforeseen expenses of an obligatory character. In most instances, the National Government makes contributions towards such requirements of from 30 per cent to 60 per cent.

However, as these grants are not always paid promptly, the "Credit Communal" discounts the promised amounts normally for a three-year period and, in exceptional cases, for five years.

(b) For Current Ordinary Expenses:

In Belgium, the State collects certain local taxes which are handed over to the "Credit Communal" to guarantee the annual service costs of municipal loans. There is frequently a delay however in turning the amounts over to the "Credit Communal". As a consequence, municipal governments require interim credit pending the payment of such taxes. For this purpose, the estimated credit balance -- which is not necessary to cover interest and repayment costs of the loans granted to the municipality -- can be discounted to enable the "communes" to pay their current expenses.

4. Direct Loans to Other Public Bodies

While direct loans to municipalities is the most important function of the "Credit Communal", the institution also grants loans to provinces and other recognized public bodies.

In the case of the nine provinces, in as much as all provincial taxes are collected by the State, these taxes, as with the State collected municipal taxes, are paid to the "Credit Communal" where they remain credited to each of the several provincial accounts and,

as with the municipalities, the unused surplus remains as a guarantee of any loan advanced to the provinces by the "Credit Communal".

With respect to joint Boards of municipalities and other local organizations, in as much as these bodies do not raise taxes and there is no government fund for them, consequently they do not have any direct income centralized at the "Credit Communal" with which to guarantee their loans. For this reason, such bodies must obtain a municipal or provincial warrant which is tantamount to a guarantee for any loan accorded to them.

Financial Assets

The financial assets of the "Credit Communal" derive from the following sources:

(a) Formerly long-term bonds were issued 30 to 60 years and with these proceeds long-term loans were granted. Included in such loan obligations was a 5 per cent capital subscription to the shares of the "Credit Communal". At the end of the second World War the issuance of long-term bonds was abolished, but the municipal share capital still remains an asset of the company.

(b) The "Credit Communal" also operates savings departments. Deposits in savings accounts are callable on demand.

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it acts as the banker for local authorities and other local public bodies. Funds of these bodies remain on deposit for varying times and, as indicated, a good portion of them are earmarked to cover the capital and interest cost repayments of any loan made to these bodies.

(c) In addition to State collected municipal taxes, local authorities also collect direct taxes and other revenues. These local taxes and revenues are deposited with the "Credit Communal".

In recent years the "Credit Communal" has been accorded wide banking powers and can, in effect, provide full banking and loan facilities on behalf of local authorities, including savings deposits and the issuance of short-term, medium and long-term loans.

The "Credit Communal" works closely with the private banks and, on the infrequent occasions when a larger municipality issues its own bonds, it acts as liaison between the municipality and the bank and as the agent of the municipality.

DENMARK

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and other local public bodies. Funds of these bodies remain on deposit for vary[illegible] times and, as indicated, a good portion of them are earmarked to cover the capital and interest cost repayments of any loan made to these bodies.

(b) In addition to State collected municipal taxes, local authorities also collect direct taxes and other revenues. These local taxes and revenues are deposited with the "Credit Communal".

In recent years the "Credit Communal" has been accorded wide banking powers and can, in effect, provide full banking and loan facilities on behalf of local authorities, including savings deposits and the issuance of medium and long-term loans.

The "Credit Communal" works closely with the private banks and, on the infrequent occasions when a larger municipality issues its own bonds, it acts as liaison between the municipality and the bank and as the agent of the municipality.

DENMARK

In Denmark the municipalities are not allowed to raise loans to meet current expenditure, but only to finance purchases of property and such new building

(roads, schools, hospitals, etc.) as cannot be financed from ordinary annual revenue.

The municipalities raise loans "inter alia" from financial institutions (banks, savings banks and insurance companies, from the banks and associations mentioned below and from their own funds, etc. They also have access to loans on favourable terms granted by the State for the promotion of building activity. The loans can be raised by the issue of bonds, quoted on the Exchange, but, generally speaking, this is only resorted to for large loans.

Municipal banking institutions proper are:

(a) The Local Government Mortgage Credit Association, the business of which is to grant loans to municipalities or under the guarantee of a local government. Each municipality which thus contracts or guarantees loans automatically becoming a member of the association;

(b) The Urban Municipalities" loan Society which, in some cases, assists the urban municipalities in raising loans and arranges the raising of collective loans.

(c) In addition, "Den danske Landmandsbank" (the Danish Farmers' Bank) has set up a special department for the grant of loans to municipalities and this is also the case with "Kongeriget Danmarks Hypotekbank" (the second mortgage association for the Kingdom of Denmark), run by the State, a

department of which is authorized to grant loans to municipalities for the financing of local works and purchases, etc., when the Ministry of the Interior is of the opinion that the work in question is in the public interest.

GERMAN FEDERAL REPUBLIC

The Ministry of the Interior exercises supervision over the local authorities and must authorize either direct or by delegation all borrowings by the local authorities. The main lenders to the local authorities are the savings banks and giro (1) institutions.

The savings banks organization is the main lender to local authorities in the Federal Republic of Germany. The local authorities are not, however, obliged to contract loans solely with the savings banks organization. They may also obtain loans from insurance companies, mortgage banks and other banks. The issue of registered bonds requires special approval by the appropriate Federal Minister.

The savings bank may grant the local authorities loans up to a maximum of 12½ per cent of their deposits. If the capacity of the savings bank is not sufficient

---

(1) The savings bank organization is a decentralized private banking system with a three-tier structure. The bottom tier and, at the same time, the most important is the savings bank. The second tier is formed by the central giro institution in each land (State) of the Federal Republic - Schleswig-Holstein, Hamburg, Bremen, Lower Saxony, Westphalia, North Rhine, Hesse, Rhineland-Palatinate, Saar, Baden, Wurttemberg and Bavaria. The top tier consists in the Deutsche Girozentrale - the chief institution of the system.

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to satisy the loan requirements of a local authority, recourse may be had to the regional giro (savings bank) institution, which is not restricted in this respect. The regional giro institutions refinance themselves in part from the Deutsche Girozentrale-Deutsche Kommunalbank, the central institution of the German savings bank organization. The latter body obtains the necessary funds for long-term loans by selling its communal bonds on the capital market. It is a constant issuer and sells the bonds to all interested parties without forming a syndicate. The floating of an issue requires the authorization of the State, which has never been refused.

The Deutsche Girozentrale-Deutsche Kommunalbank is not obliged to use the proceeds of the sale of communal bonds and debt certificates solely for the granting of loans to local authorities. It can advance funds to any borrower provided the loan is guaranteed by an authorized public authority. No security is required for loans to local authorities.

The municipal authorities require mainly long-term loans which are redeemed in annuities. Consequently, the terms of the communal bonds are so fixed that loans with terms of 25, 30 to 40 years can be granted.

The sum of the loans granted by the Deutsche Girozentrale-Deutsche Kommunalbank is to a certain degree dependent on the sales of communal bonds and debt certificates; in other words, the Bank must restrict its lendings if the capital market is barren.

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NETHERLANDS

The Bank for Netherlands Municipalities ("N.V. Bank voor Nederlandscha Gemeenten") in its present form was established in 1922. It was the successor of the "Gemeentelijke Creditetbank", which was established in 1914 on the initiative of the Netherlands Association of Local Authorities.

Structure and Management

The bank is a limited liability company of which 50 per cent of the share-capital (100 million guilders) is in the hands of the central government with the remaining 50 per cent being in the hands of municipalities, provinces and other public corporations. 786 of the 982 Netherlands municipalities and 7 of the 11 provinces are shareholders of the bank.

Because it holds a large proportion of the shares, the State has the right to appoint two directors of the Netherlands Bank. But these have only an ordinary vote at meetings, both of the Board of Trustees and of its supervisory sub-committee. The number of votes of the central government in the meeting of shareholders is limited to six. (The same number as a local authority holding 28 or more shares). The central government, however must approve the appointment of the bank managers, the issue of loans, any alteration of the statutory regulations and the annual accounts. The fact that some of the transactions of the bank are subject to the approval of the State has not proved in practice that thereby the State's participation hampers in any way an independent banking policy.

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Like every limited liability company the bank has a board of directors. The board consists of twelve persons.... One of its members is appointed by the Minister of Home Affairs, one by the Minister of Finance and two by the Association of Netherlands Municipalities. The other eight directors are appointed by the General Meeting of Shareholders. The management is in the hands of one manager and two assistant managers.

The participation of the State imparts a very special character to the institution. It is this character which makes the bank a willing partner in helping to draw up and carry out plans to obviate any difficulties which happen to arise in connection with municipal credit. In general, it can be said that, if in times when capital or credit demand exceeds supply a co-ordination is needed between the demands of the State and local authorities, such co-ordination is facilitated by the existence of a bank in which the State has both a shareholding and supervisory interest.

Activities

The principal functions of the Bank are:

(a) the granting of long-term loans, short-term loans and current-account credits to local authorities and other public corporations, as well as to quasi public-corporations;

(b) the settlement of claims and debts between the government and the municipalities are realized through the bank;

(c) its primary task is to lend all possible

bank assistance to the local authorities.

The credits of the Bank are financed by the following means:

(a) the issue of bond loans;

(b) the contracting of long-term and short-term private loans with pension funds, insurance companies, saving banks, and others;

(c) deposits received from the local authorities and other public, as well as quasi public corporations;

(d) borrowing from the State occurs only in very special cases.

At the end of 1961 the parliament of the Netherlands had before it a Bill for the purpose of regulating the financing of the capital expenditures of local authorities. The purposes of the Bill were threefold:

(1) To assure a safe financing of the capital expenditures of local authorities, particularly the smaller municipalities.

(2) To assure that the aggregate capital borrowing of local authorities on the capital market would be such as to maintain a desirable level of borrowing having regard to the cyclical fluctuations in the national economy.

(3) To prevent a possible over-straining of the capital market in so far as the long-term capital requirements of local governments are concerned.

The following table indicates the growth in the operations of the Netherlands Bank since its re-organization in 1922.

KEY FIGURES SINCE 1922.

(IN MILLIONS OF GUILDERS)

YEAR	SHARE CAPITAL AND RESERVES 1)	LONG-TERM LOANS EXTENDED 1)	DEBTORS ON CURRENT ACCOUNT 1)	CURRENT-ACCOUNT CREDITORS AND TIME-DEPOSITS 1)	LONG-TERM LOANS RAISED 1)	PAYMENTS BY THE GOVERNMENT TO THE MUNICIPALITIES	PAYMENTS TO THE GOVERNMENT BY THE MUNICIPALITIES	NUMBER OF HOLDERS OF CURRENT ACCOUNTS 1) 2)
1922	2,0	4,1	0,5	3,4	2,6	-	-	49
1930	4,7	37,6	11,7	11,2	34,0	316,5	72,2	557
1940	7,2	35,0	18,5	9,7	28,4	437,7	72,3	772
1950	9,8	200,1	76,8	53,8	190,7	1.019,3	122,2	1.035
1960	120,1 3)	6.124,4	92,1	211,8	6.039,4	2.809,6	96,7	1.334
1961	130,9 4)	6.674,6 5)	120,8	232,6	6.465,6	3.295,8	324,5	1.329 6)

1) END OF YEAR FIGURES.

2) NUMBER OF CORPORATIONS USING THE SERVICE OF THE BANK TO RECEIVE FUNDS OR TO MAKE PAYMENTS.

3) SHARE CAPITAL F. 90.217.000,--, OF WHICH UNCALLED F. 74,764.400,-- .

4) SHARE CAPITAL F. 100.000.000,--, OF WHICH UNCALLED F. 83.549.000,-- .

5) LOANS OUTSTANDING AT 31ST DECEMBER, 1961, REPRESENTED CLAIMS MADE UP AS FOLLOWS:

	NUMBER OF LOANS	AMOUNT
PROVINCES	11	F. 25.948.480,--
MUNICIPALITIES	24.221	" 6.383.980.443,47
POLDER BOARDS (A)	66	" 3.937.752,76
PUBLIC UTILITIES	138	" 73.503.891,72
SCHOOLS	525	" 94.167.167,08
BUILDING SOCIETIES	92	" 49.950.709,55
OTHERS	131	" 43.291.558,75
	25.184	F. 6.674.580.003,33

6) INCLUDING 969 OF THE 982 NETHERLANDS MUNICIPALITIES; THE NUMBER OF MUNICIPALITIES DECREASES BECAUSE THERE IS A TENDENCY TO FORM BIGGER MUNICIPALITIES OUT OF LITTLE ONES.

(A) WATER CONSERVATION DISTRICTS.

SPAIN

The over-all picture with respect to municipal borrowing in Spain in 1925 was somewhat as follows:

(a) The Stock Exchanges of Madrid and Barcelona absorbed the borrowing requirements of the two larger cities (70 per cent of the total municipal debt); and, to a lesser extent, certain of the provincial capital cities;

(b) The Savings Funds institutions in the provinces provided the credit requirements of some municipalities, such loans being secured by the bonds of the provinces;

(c) Only 5 per cent of the aggregate of Spanish municipalities had contracted loan obligations. It was only under exceptional circumstances that they could borrow funds for capital works or other purposes.

Under these circumstances the credit and borrowing needs of municipal governments were wholly inadequate. This fact was recognized by the National Government and, in a municipal statute passed in 1924, authorization was given for the setting up of a National Municipal Lending institution. For the purpose it was decided to establish a Municipal or Communal Credit Bank which would have the direct support of the capital market, to which end it was recognized that the bank would have to be provided with the means necessary to

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carry on its functions and to establish the confidence of the market.

In general, the premises upon which the bank was founded and its modus operandi can be summarized as follows: The difficulty of having the market know, evaluate and accept the guarantee of each and every municipality that required credit would be overcome if there was an official institution that would be worthy of the confidence of the market and that could perform this function and which, through its consolidated strength, could obtain at minimum interest costs the borrowing requirements of local governments.

In effect, therefore, the local Credit Bank of Spain serves as a liaison and as an agent between the capital market and the municipalities. Thus, the possibilities of obtaining credit are common to all of them and not limited only to the larger cities... In the market there is no debtor municipality, but only the local Credit Bank which represents the aggregate of the resources of all the municipalities, all of which are pledged to secure the obligations contracted, with the Credit Bank being responsible for the servicing of the aggregate debt obligations... The bank maintains a continuous re-evaluation of the borrowing potential of every municipality. Within that potential the bank undertakes to obtain from the capital market the borrowing requirements of the municipality.

The bank was established on July 22, 1925. It is an official government bank and operates as a stock company with both private and public shareholders. Its

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initial capital was Ptas 25 million. Its present capital consists of 100,000 shares of a value of Ptas 500 each, of which 40 per cent is subscribed by municipal governments... The Board of Administration of the bank is presided over by a Governor who is appointed by the National Government and he, in turn, appoints two Deputy Governors... Elected representatives of both the private shareholders and the municipal shareholders constitute the Board cf Administration with the provision being made whereby the municipal shareholders exercise certain powers alone.

The bank has the power of issuing local credit bonds (or share certificates) to cover the amounts of the loans contracted by the borrowing municipalities. These bonds or share certificates known as "Cedulas" are an instrument devised by the bank to facilitate and direct local capital into municipal undertakings. No other entity may issue "Cedules" so that this form of investment is strictly limited to municipal credit requirements... In possible cases of default by a municipality, the bank is authorized to establish executory proceedings on the municipality through means of compulsory collection of any amounts in default. There have been a few threatened defaults (coinciding with the financial crisis of 1930) but the executory proceedings were immediately put into effect so that in no single case did the threatened default develop. Not even the contingencies of the Civil War result in a municipal default, nor have any developed since then.

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the bank immediately attracted the attention of the market and were broadly accepted not only by the market, but by the private banks and other sources of private investment.

The number of loan transactions entered into between the period 1925 to 1960 totalled 3,526, involving more than Ptas 9,200 million, loaned to more than 2,000 local governments. The rural municipalities, small towns and large cities have all utilized the facilities of the bank without any discrimination whatsoever. The smallest loan granted was to the town of Castronuevo in the amount of Ptas 27,000 for a public services building. The largest loan was in the amount of Ptas 550 million to the City of Barcelona for the improvement of urban transportation.

Since its inception only five municipal governments, because of special circumstances, have placed their securities directly on the market with the co-operation of the local Credit Bank which provides municipal governments with full technical facilities and financial planning of their borrowing requirements.

The bank commenced its operations by giving preference to municipal improvements of a self-liquidating nature, even though it did not exclude other types of municipal undertakings that required urgent attention. Its initial effort, however, was to fill the void created by the inability of municipal governments to establish acceptable credit in the money market and, particularly, for the smaller municipalities who, as indicated, were finding it difficult to obtain their borrowing

requirements from any source.

Within the framework of this policy, the bank's early operations were, to a large extent, confined to providing the capital costs of water and sewerage systems, markets, abattoirs, schools and road construction.... Since 1940, loans have been extended to include such items as housing, urban transportation and re-development... Of the total loans granted in 1960 (Ptas 2,042 million) 50 per cent represented loans for water supply and sewer construction; 30 per cent represented loans for urban transportation; 14 per cent for schools, welfare and related purposes; 6 per cent for urban re-development; 3 per cent for local roads and highways and 3 per cent for municipal buildings.

From the inception of the bank the local credit "Cedula" has been an important instrument in providing the borrowing requirements of municipal governments. The first issue of "Cedulas" took place in 1925. Originally they bore an interest of 6 per cent per annum. In 1942, all "Cedulas" in circulation were converted into an issue bearing a rate of 4 per cent per annum. This rate is still in force. While the interest rate of the new issue was lowered, a fully compensating measure was introduced whereby "Cedulas" were exempted from all taxation (national, provincial or municipal). There have been ten subsequent issues of "Cedulas", all tax exempt, bearing a 4 per cent interest rate.

Another attractive feature of the "Cedula" is the provision whereby there are annual draws or prizes

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for "Cedula" owners, somewhat in the same manner as the "bonus bonds" of the United Kingdom. The prizes are of three kinds:

(a) fixed prizes for each issue -- one of Ptas 250,000, one of Ptas 100,000 and several of twice the nominal value of the "Cedula";

(b) variable prizes for all issues, established by sharing in the profits of the bank. In the year 1960, this resulted in the distribution of Ptas 3,707,000 among 719 "Cedulas";

(c) variable prizes for all issues by distribution of a fund set up by a special commission of 1 per cent on all loans since December 1956.

The bank has become a firmly established financial institution in Spain with the total amount of loans authorized in 1960 amounting to Ptas 2,042 million... The policy of its earlier years whereby loans were restricted, in the main, to self-liquidating projects, has given way to a much broader policy. The criteria now is whether a project has a social usefulness. If it has, and providing there is some reason to believe the municipality can fulfill its debt obligation, the bank will undertake to arrange that the municipality is able to discharge its loan obligation.

UNITED KINGDOM

Municipal authorities in the United Kingdom are required by law to raise sufficient revenue to discharge their current expenditures so that borrowing is generally confined to specific capital purposes.

Long-term loans may be raised by local authorities for financing capital expenditures, e.g. the acquisition of land, the erection of buildings and other permanent work, and similar purposes. With very few exceptions, long-term loans are subject to the consent of the Minister of Housing and local Government who is guided by the recommendations of the government department responsible for the service for which the capital is required. Borrowing powers for specific schemes are sometimes included among the provisions of local Acts, while the London County Council goes each year to Parliament for sanction to raise the money it needs for capital expenditure.

Local authorities raise loans by issuing stock upon the Stock Exchange, by internal borrowing (e.g. from superannuation funds), by private mortgage (e.g. from savings banks), or on mortgage from the Public Works Loan Board which is financed by the Exchequer. In some circumstances, one local authority may borrow from another, e.g. a parish council from a county council. Money may also be borrowed temporarily, e.g. by bank overdraft pending the receipt of revenues or the raising of a loan.

Loans must be repaid within a period of years (fixed usually by the department which recommends the loan)

which varies according to the anticipated life of the capital assets for which the loan is raised, and is never longer than eighty years. Municipal authorities may borrow from any source provided the security given is of an authorized nature; for example, loans on mortgage. The mortgages referred to are given on security of the rates and revenues of the borrowing municipality, but alternative forms of loans are also available; for example, local bonds and bills, housing bonds, bank overdraft.

There is no special local government bank operating on behalf of local authorities in the United Kingdom, although the Public Works Loan Board has some of the charzcteristics of a national municipal loan institution. It is the only department of the Government of the United Kingdom which is entirely concerned with the financing requirements of local government. The Board is a statutory body for which the Chancellor of the Exchequer has parliamentary responsibility and local governments may borrow from it at rates fixed by the Treasury.

All loans from the Public Works Loan Board are repaid by instalments; other loans may be repaid either by instalments or by means of a sinking fund.... The rates of interest for loans from the Public Works Loan Board are fixed from time to time by the Treasury to correspond broadly with current market rates.

IRELAND

All local authorities in Ireland have power to raise loans by issue of stock. The issue and terms require sanction from the Minister of Finance. In practice, only two local authorities raise loans by this method, viz. the Corporation of Dublin and the Corporation of Cork.

There is no special local government bank in Ireland, although there is a local loans Fund which is a fund financed by the Central Government for the purpose of facilitating municipal capital borrowing. Most local authorities contract loans through this government fund. The usual period of such loans is thirty-five or fifty years and the interest rate generally is lower than the going market rate for capital funds. In 1960, it was $3\frac{1}{4}$ per cent for "municipal" loans and $2\frac{1}{2}$ per cent for "housing" loans.

Short-term borrowing is usually done with the ordinary commercial banks on such occasions when credit facilities are required to tide a local authority over a period of temporary difficulty pending receipt of income from the rates.

ITALY

Municipal authorities in Italy may contract loans for the specific purposes laid down by municipal law, such as public works of an obligatory nature, working-class housing, payment of outstanding debts, and to balance deficits in the municipal budget.

These loans may be contracted with special loan establishments such as the "Deposit and Loan Bank", the savings banks and other credit and loan institutions. Municipal loans are covered by assignments on municipal sur-taxes and on local taxes. These loans are generally repaid by means of uniform annual instalments comprising the capital and the interest. Municipalities are forbidden to contract loans abroad.

To meet their current credit requirements municipalities may contract loans in the form of drafts for a sum which must not be more than 1/8 of the ordinary budget receipts.

Municipalities may also issue stocks. This method, however, is only used by the larger municipalities and the stocks are quoted on the Stock Exchange.

There is no special bank for local government credit requirements although the "Deposit and Loan Bank", which combines all the deposits of post office savings banks, judicial deposits, etc., and which uses these assets for loans to public bodies, such as the municipalities and the provinces, by its nature, performs much of the purposes normally undertaken by national municipal loaning institutions.

FRANCE

Municipal governments in France are authorized to contract loans for municipal public works undertakings. There is no special national lending institution so that municipalities borrow from whatever source they can

obtain funds from. The only restriction is in the case of loans which are intended to meet the municipal cost of works that have been subsidized in part by the national government.

For such loans the municipalities are obliged to have recourse to "local" loan sources. While local loans are originally what the word implies, namely loans from "local" sources, in practice a local loan now has come to mean a loan from any source other than certain public State Banks whose funds are specifically reserved for specified purposes and do not include municipal purposes.

The larger cities such as Paris and Marseilles issue their own securities which are quoted on the Stock Exchange. Other municipalities can avail themselves of a special government administrative agency known as the "Deposit and Consignment Office". This agency of the National government operates what is known as "The Fund for Administering Loans of Local Authorities". It does not act as an intermediary for the municipalities in obtaining loans but only as the custodian and administrator of such loans after they have been negotiated by the borrowing municipality. While it in no way guarantee a municipal loan, the fact that the loan is under its administration gives to the loan an added receptivity in the market. The supervision of such loans is under the control of a committee comprised of representatives of the municipalities, the departments and the National Federation of Local Authorities.

The assets represented by the municipal loans

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being administered by the Deposit and Consignment office are listed and quoted on the Stock Exchange under the name of the Municipal Administration Fund. This provides a market for such assets which would not be possible for each individual loan represented by the assets owing to the smallness of many of such loans and the fact that a large part of the borrowings are those of relatively small communities.

TURKEY

Local authorities in Turkey may raise loans with the approval of the state supervisory authority. Such loans must be for capital expenditures only. Municipal loans to cover current expenditure are forbidden.

In most instances, the municipalities obtain their borrowing requirements from the Departmental Bank. This is a public credit institution, founded in 1945, on the basis of intermunicipal co-operation, to replace the Municipal Bank founded in 1930.

The Departmental Bank has a capital of 200,000,000 Turkish pounds, the shareholders being the departments (or provinces), urban municipalities and rural villages. The departments and municipalities are required by law to remit to the bank annually one-twentieth of their ordinary annual revenue as their share in the bank's capital until this has been fully paid up. The villages, though shareholders in the bank, make no payment, their contribution being represented by three per cent of the

revenue of the rates on built-up property which is collected and paid into the bank by the departments and by thirty per cent of the net annual profit made by the bank.

The purpose of the bank is to lend to local authorities -- at a reduced rate and on advantageous terms -- the funds necessary for municipal equipment and for carrying out programmes of urban improvement and municipal public works.

Local authorities can borrow from other sources besides the Departmental Bank. However, they cannot issue stocks and shares. In 1953 in order to facilitate urban re-development and municipal improvements in the larger cities and towns the government authorized such municipalities to issue debenture bonds redeemable in twenty years. Such bonds must be approved by the government and the borrowing arranged with the Banque de Credit Foncier de Turquie. The bonds are backed by a government guarantee.

NORWAY

The National Government of Norway have established what is known as a "Kommunalbanken". The Kommunalbanken is, as its name implies, a municipal bank. It is the principal source of municipal capital funds in Norway although municipalities may also contract loans from private persons, banks or directly from the state or other financial bodies. They may also raise loans by the issue of stocks on the Stock Exchange.

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SWEDEN

Municipal governments in Sweden may contract loans, in principle, from anyone including loans by the issue of stock although this is not a frequent practice. There is no national municipal lending institution in Sweden.

The capital, Stockholm, is the only municipality in Sweden which borrows money by issuing bonds.

FINLAND

Local authorities in Finland may contract loans from any source... Loans with an amortization period exceeding five years, however, require the approval of a central government authority. The approving authority for rural communities is the County Administrator and for cities and towns it is the Minister of the Interior.

There is no national municipal lending institution in Finland.

AUSTRIA

Local authorities in Austria are permitted to raise loans, which they do from private individuals, banks, the State and, more particularly, from lending institutions of various kinds. Loans are secured by mortgaging the income of the municipality.

Loans can also be raised by the issue of debentures quoted on the Stock Exchange.

There is no special local government bank operating on behalf of local authorities in Austria.

APPENDIX "B"

MUNICIPAL FINANCIAL STATISTICS (1933-1959)

1. Net General Revenues by Major Tax and Other Revenue Sources.

2. Total Net General Revenue by Province.

3. Net General Expenditures by Major Function.

4. Total Net General Expenditure by Province.

5. Direct and Indirect Debt.

MUNICIPAL GOVERNMENT - NET GENERAL REVENUE BY MAJOR TAX AND OTHER REVENUE SOURCES
SELECTED YEARS: 1933 - 1959
(MILLIONS OF DOLLARS)

	A. TAXATION							B. OTHER REVENUES					C. PROVINCIAL PAYMENTS	
	INCOME TAX													
YEAR	CORPORATE	INDIVIDUAL	GENERAL SALES	OTHER SALES	REAL AND PERSONAL PROPERTY	OTHER TAXES	TOTAL TAXES (A)	PRIVILEGES LICENSES PERMITS	GOVERNMENT ENTERPRISES	OTHER	TOTAL OTHER REVENUE (B)	SUB-TOTAL (A-B)	PROVINCIAL SUBSIDIES, ETC. (C)	TOTAL NET REVENUE (A-B C)
1959	-	-	74	3	1,196	8	1,281	25	45	103	173	1,454	91	1,545
1958	-	-	58	4	1,060	10	1,132	24	45	93	162	1,294	85	1,379
1957	-	-	53	3	974	7	1,037	22	37	84	143	1,180	74	1,254
1956	-	-	51	3	860	10	924	20	35	78	133	1,057	52	1,109
1955	-	-	43	3	764	18	828	19	32	64	115	943	45	988
1954	-	-	37	2	709	15	763	17	36	60	113	876	42	918
1953	-	-	34	2	651	13	700	16	33	62	101	811	30	841
1952	-	-	30	2	600	14	646	14	30	47	91	737	29	766
1951	-	-	27	2	531	10	570	13	29	48	90	660	24	684
1950	-	-	25	-	400	53	478	14	24	44	82	560	15	575
1949	-	-	16	-	369	48	433	13	24	42	79	512	9	521
1948	-	-	15	-	337	41	393	12	20	30	62	463	8	471
1947	-	-	13	-	304	34	351	10	19	33	62	413	6	419
1946	-	-	12	-	275	29	316	9	16	34	59	375	7	382
1945	-	-	9	1	278	4	292	6	17	30	53	345	6	351
1943	-	-	8	-	260	25	293	8	14	26	48	341	7	348
1941	-	4	7	-	251	24	286	8	12	25	45	331	3	334
1939	1	3	5	-	243	23	275	7	10	25	42	317	5	322
1937	1	3	4	-	237	21	266	6	9	23	38	304	3	307
1933	-	4	-	-	231	18	253	5	6	30	41	294	-	294

SOURCE: D.B.S. (SPECIAL COMPILATION)

MUNICIPAL GOVERNMENTS - TOTAL NET GENERAL REVENUE BY PROVINCE
(INCLUDING UNCONDITIONAL TRANSFERS FROM PROVINCIAL GOVERNMENTS)
SELECTED YEARS: 1933 - 1959
(MILLIONS OF DOLLARS)

YEAR	NEW-FOUNDLAND	PRINCE EDWARD ISLAND	NOVA SCOTIA	NEW BRUNS-WICK	QUEBEC	ONTARIO	MANITOBA	SASK-ATCHEWAN	ALBERTA	BRITISH COLUMBIA	TOTAL
1959	6	3	39	36	383	628	73	88	138	151	1,545
1958	5	3	36	33	326	562	68	83	127	136	1,379
1957	4	2	34	30	293	519	64	78	112	118	1,254
1956	4	2	30	26	267	453	59	71	97	100	1,109
1955	3	2	27	24	239	400	53	66	87	87	988
1954	3	2	25	22	226	360	49	62	85	84	918
1953	2	2	24	21	217	319	46	57	76	77	841
1952	2	2	23	19	193	293	45	51	68	70	766
1951	2	1	20	16	182	254	42	46	58	63	684
1950											575
1949											521
1948					BREAKDOWN NOT AVAILABLE						471
1947											419
1946											382
1945	-	1	12	9	100	125	23	27	28	28	351
1943	-	1	11	8	94	128	22	30	27	27	348
1941	-	-	10	8	92	133	21	22	23	25	334
1939	-	-	10	7	84	131	21	22	23	24	322
1937	-	-	9	6	81	133	20	15	21	22	307
1933	-	-	9	5	73	128	19	17	20	23	294

SOURCE: D.B.S. (SPECIAL COMPILATION).

MUNICIPAL GOVERNMENTS NET GENERAL EXPENDITURE BY MAJOR FUNCTION

SELECTED YEARS: 1933 - 1959
(MILLIONS OF DOLLARS)

YEAR	HEALTH	SOCIAL WELFARE	EDUCATION	TRANSPORT & COMMUN.	DEBT CHARGES	GENERAL GOV'T	PROTECTION PERSONS & PROP.	OTHER	TOTAL
1959	68	38	658	346	118	129	212	284	1,853
1958	75	34	522	309	101	121	191	241	1,594
1957	81	32	494	296	85	109	172	229	1,498
1956	70	34	440	226	67	101	156	221	1,315
1955	65	33	386	221	50	89	148	179	1,173
1954	65	29	384	176	50	78	128	212	1,122
1953	52	27	378	167	45	73	111	157	1,010
1952	52	27	331	147	39	62	103	146	907
1951	41	25	283	123	36	55	102	122	787
1950	40	74	246	110	35	(A)	(A)	177	682
1949	37	71	220	102	31	(A)	(A)	158	619
1948	33	58	188	90	28	(A)	(A)	148	545
1947	26	47	135	72	30	(A)	(A)	137	447
1946	21	39	118	67	32	(A)	(A)	114	391
1945	21	16	108	48	29	40	43	39	344
1943	15	25	94	33	41	(A)	(A)	94	302
1941	16	23	86	30	47	(A)	(A)	92	294
1939	16	35	87	28	52	(A)	(A)	88	306
1937	15	39	81	28	53	(A)	(A)	82	298
1933	15	42	77	27	60	(A)	(A)	82	303

(A) INCLUDED IN "OTHER EXPENDITURE"

SOURCE: D.B.S. (SPECIAL COMPILATION).

MUNICIPAL GOVERNMENT - TOTAL NET GENERAL EXPENDITURE BY PROVINCE

SELECTED YEARS: 1933 - 1959
(Millions of Dollars)

YEAR	NEW-FOUNDLAND	PRINCE EDWARD ISLAND	NOVA SCOTIA	NEW BRUNSWICK	QUEBEC	ONTARIO	MANITOBA	SASK-ATCHEWAN	ALBERTA	BRITISH COLUMBIA	TOTAL
1959	6	3	47	41	377 (A)	820	85	108	180	186	1,853
1958	6	4	43	39	278 (B)	727	76	96	158	167	1,594
1957	7	3	39	34	248 (B)	699	71	89	155	153	1,498
1956	5	3	33	33	229 (B)	602	66	82	138	124	1,315
1955	3	3	28	29	202 (B)	540	64	74	120	110	1,173
1954	3	3	29	27	197 (B)	505	58	69	114	117	1,122
1953	3	2	27	26	251	379	53	61	113	95	1,010
1952	2	2	27	24	237	339	48	54	91	83	907
1951	1	2	25	20	201	294	46	47	76	75	787
1950											682
1949											619
1948					BREAKDOWN NOT AVAILABLE						545
1947											447
1946											391
1945	-	1	11	9	92	126	24	27	26	28	344
1943	-	1	10	7	83	110	20	24	23	24	302
1941	-	1	10		86	106	20	21	21	23	294
1939	-	1	10	7	91	112	21	20	21	23	306
1937	-	1	10	7	85	114	21	18	20	22	296
1933	-	1	9	6	85	123	20	18	19	22	303

(A) INCLUDES CAPITAL EXPENDITURE FOR SCHOOLS $56 MILLION (OUT OF CAPITAL FUNDS).
(B) DOES NOT INCLUDE EXPENDITURE OUT OF CAPITAL FUND.

SOURCE: D.B.S. (SPECIAL COMPILATION).

MUNICIPAL GOVERNMENTS DIRECT AND INDIRECT DEBT
BY PROVINCES FOR SELECTED YEARS: 1933 - 1959
(Millions of Dollars)

YEAR	NEW-FOUNDLAND	PRINCE EDWARD ISLAND	NOVA SCOTIA	NEW BRUNSWICK	QUEBEC	ONTARIO	MANITOBA	SASK-ATCHEWAN	ALBERTA	BRITISH COLUMBIA	TOTAL
1959	19	7	100	95	1,422	1,570	148	144	445	363	4,333
1958	16	6	88	89	1,198	1,440	125	124	393	344	3,823
1957	17	7	78	82	1,028	1,266	118	111	366	316	3,387
1956	14	8	73	74	969	1,110	105	99	317	288	3,085
1955	11	6	62	69	855	945	94	66	261	273	2,662
1954	7	5	61	64	772	854	84	73	227	209	2,356
1953	6	4	56	58	681	746	73	57	181	196	2,058
1952	5	4	52	54	602	623	69	49	145	181	1,784
1951	4	4	45	47	549	546	66	47	125	151	1,584
1950											1,323
1949											1,175
1948				BREAKDOWN NOT AVAILABLE							1,056
1947											976
1946											983
1945											992
1943	-	2	22	19	472	282	60	76	50	93	1,076
1941	-	3	25	22	503	342	72	87	57	103	1,214
1939	-	3	27	22	523	413	82	98	62	111	1,341
1937	-	3	27	23	507	464	96	87	67	112	1,386
1933	-	2	29	22	503	540	100	68	74	118	1,461

SOURCE: D.B.S. (SPECIAL COMPILATION)

Royal Commission on Banking and Finance

THE GOVERNMENT OF THE PROVINCE OF ONTARIO

Hearings held at

OTTAWA

Vol.	Date.
56	October 30, 1962

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

ROYAL COMMISSION ON BANKING

AND FINANCE

- - - - - -

Hearings held at Ottawa, Ontario, on Tuesday, October 30th, 1962.

- - - - - -

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

- - - - - - - -

Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Ottawa, Ontario,
Tuesday, October 30th, 1962.

--- On resuming at 9.30 A.M.

SUBMISSION OF THE

GOVERNMENT OF THE PROVINCE OF ONTARIO

APPEARANCES

Hon. J.P. Robarts	-	Prime Minister of the Province of Ontario
Hon. R.W. Macaulay	-	Minister of Economics and Development
Hon. J.W. Allan	-	Treasurer
S.W. Clarkson	-	Deputy Minister of Economics and Development
H. Brown	-	Deputy Treasurer
F. Hickey	-	Asst. Deputy Minister, Dept. Municipal Affairs.
D.W. Stevenson	-	Director, Economics Branch Dept. Economics & Development.
Professor S. Triantis	-	University of Toronto.
D.R. Richmond	-	Asst. Director, Economics Branch, Dept. Economics & Development.

THE CHAIRMAN: We are very pleased indeed to have a representation this morning from the Government of Ontario. We have all read your brief with great interest and look forward to the discussion that will no doubt ensue. I understand, Mr. Premier, that you wish to make a preliminary statement yourself, to be followed by a statement from Mr. Macaulay?

PREMIER ROBARTS: Yes, My Lord. I thought I would perhaps read this relatively short

introduction which sets out in essence our basic position. Mr. Macaulay will then make further submissions to you. Also, we have with us Mr. Allan, the Treasurer, Mr. Brown, the Deputy Treasurer; Mr. Clarkson, the Deputy Minister of Economics and Development, plus certain members of their staffs who can give you detailed answers that you may require.

If I may, then, proceed, I would say that I welcome this opportunity to appear before the Royal Commission on Banking and Finance and to have an opportunity to present the views of the Government of Ontario on these questions which are so vitally important to the economic health and well-being of Canada and this province.

As I have said, following these brief remarks the Minister of Economics and Development will outline our specific recommendations in greater detail.

In my opinion, the investigation which your Commission is making into the question of the operation of our financial system and monetary policies is extremely appropriate because we are in a crucial period in the economic development of our country. I can assure you that we in the Province of Ontario are deeply concerned with many of the problems with which you are grappling. It is my understanding that you have already reviewed copies of our brief. You are aware that we have restricted our remarks, in the main, to matters of policy rather than to specific details. Officials of my Government from the Departments of Economics and Development, Treasury and

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Municipal Affairs are, however, prepared to answer questions arising out of the material submitted in our brief. I can assure you that these gentlemen will welcome the opportunity to answer specific questions which you may have for them about our presentation.

If I may digress for a moment I would like to say how very pleased I am to see that the appointment of your Commission has been followed by a Royal Commission on Taxation. I would, of course, have been even more pleased if the Federal Royal Commission on Taxation had been given broad powers to study, examine and make recommendations upon the whole problem of the present distribution of taxation powers and financial responsibility between the Federal Government and the Governments of the Provinces. I have advocated such a Royal Commission for some time and I have already gone on record as stating that the Ontario Government will appoint a committee to study the problems of taxation within Ontario's jurisdiction.

In my view, the problems of financing municipal and provincial government operations in Canada today cannot be entirely divorced from considerations of their revenue resources. This, to us, seems to indicate that your Commission in the course of performing its extremely valuable function, will have its task made more difficult by the fact that the whole field of government incomes and tax revenues has not been thoroughly studied for some twenty-four years. Even though we will have to wait some time for the reports from the various Commissions on Taxation, your

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Commission will assuredly play an important role in devising policies to assist in the continued economic expansion of Canada.

The Twentieth Century has revolutionized man's thinking on the permanency and perfectibility of his institutions. If nothing else, we have learned that what we create today may well be obsolete tomorrow. This is true in terms of machines as well as in terms of economic and social development. I would suggest, for example, that very few, even among visionaries, at the turn of the Century would have prophesied the consolidation of an economic union in Europe. Yet, with the establishment of the European Economic Community this has come about. We, in Ontario and, I think, in Canada, are therefore becoming more and more aware of the need to re-examine our methods and policies in order to ensure that they are adequate, efficient and capable of meeting the needs of a rapidly changing environment.

At the present time, we in Ontario are faced with the prospects of a reorganization of parts of our economy, and in particular our secondary manufacturing industry. In the coming years, if present indications continue, lower tariffs on manufactured goods will mean adjustments in the competitive forces now at work in our economy. A great deal of capital will be required to enable our manufacturing and other facilities to adapt to the new conditions as they arise. We in Ontario are going to do our utmost to see that our manufacturing industries take advantage

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of every opportunity presented by these changing economic forces. Furthermore, we recognize that one of the most vital ingredients of change is an efficiently operating and flexible banking and financial system which allows capital to be channelled into the most productive sectors of our economy as smoothly as possible.

We cannot over-estimate the importance which the Ontario Government places on such a banking and financial system. Even though we have fallen slightly behind in the height of the buildings which house our banks and financial institutions, I am advised that Bay Street still remains the financial heart of Canada. We have almost every type of financial institution in this Province. These institutions are a great source of strength to the economy, although like all works of human hands and minds, they undoubtedly have some weaknesses. The main purpose of your inquiry, I should judge, is the finding of any weaknesses which may have arisen and the recommending of ways in which they may be corrected and ways to improve on present policies and practices. In our brief we make some observations and recommendations which we hope will help in your task.

Fundamental to the recommendations contained in this Government's submission is our conviction that the over-riding goal of economic and financial reorganization and policy should be economic growth. To achieve this end, all other economic goals should be subordinate. Since in our democratic system, the

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responsibility for deciding the goals to be pursued and the general methods of implementing these goals rests with the elected representatives, it should be made clear by statute that the Bank of Canada is an instrument through which the Government of Canada can achieve some of its economic goals.

In our submission, we stress the importance to economic expansion of investment in human capital or intangible assets, of which a progressing system of education represents a prime example, and the role of the provinces and the municipalities in providing it. Such investment in intangible assets may provide a greater return than investment in physical assets of buildings, machinery and so on. For this reason, those agencies engaged in the provision of human capital must be assured of adequate revenues. Details of our views in this regard are set out in the main body of our brief.

Among our other recommendations we urge that selective credit procedures be adopted to facilitate our exports and prevent discrimination against small business.

We recommend that a national institute of economic research be established.

We recommend that a provincial nominee be appointed to the Board of Directors of the Bank of Canada.

We recommend that the ceiling on chartered bank interest rates be raised.

We recommend that a uniform and simplified basis for expressing effective interest rates be

[illegible]

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We recommend that a national institute of economic research be established.

We recommend that a provincial nominee be appointed to the Board of Directors of the Bank of Canada.

We recommend that the ceiling on chartered bank interest rates be raised.

We recommend that a uniform and simplified [illegible] for expressing effective interest rates be

made compulsory.

We recommend that the present withholding tax levied on the interest on provincial and municipal bonds held abroad be abolished.

Among these recommendations are a number of ideas which, if implemented, will, we think, promote economic development in this country and in this province. On aspects more directly related to the financing of the provincial government and the municipalities in Ontario you will be able to obtain additional information about our thinking from the officials of my government present here today.

I would like to emphasize in closing this introduction that the purpose of our submission is not to provide you with details of the operations of financial institutions in this Province nor to give you information which the research staff of your Commission has probably already collected. What we are presenting is the thinking of the Government of Ontario on some aspects of the over-all operation of the financial and banking system in this Province. The recommendations we have made have been for the purpose of ensuring that our financial and banking system is a force for economic growth in this country.

That completes the introductory remarks, Mr. Chairman.

THE CHAIRMAN: Thank you , Mr. Prime Minister. Mr. Macaulay?

MR. MACAULAY: Thank you, sir. I would say to you at once that the comments I will be making

[illegible]

We recommend that the present withholding tax levied on the interest on provincial and municipal bonds held abroad be abolished.

Among these recommendations are a number of ideas which, if implemented, will, we think, promote economic development in this country and in this province. On aspects more directly related to the financing of the provincial government and the municipalities in Ontario you will be able to obtain additional information about our thinking from the officials of my government present here today.

I would like to emphasize in closing this introduction that the purpose of our submission is not to provide you with details of the operations of financial institutions in this Province nor to give you information which the research staff of your Commission has probably already collected. What we are presenting is the thinking of the Government of Ontario on some aspects of the over-all operation of the financial and banking system in this Province. The recommendations we have made have been for the purpose of ensuring that our financial and banking system is a force for economic growth in this country.

That completes the introductory remarks, Mr. Chairman.

[illegible] Minister. Mr. Macaulay?

MR. MACAULAY: Thank you, sir. I would say to you at once that the comments I will be making

on this brief can be contained, I believe, within a 20-minute period. I will not be reading to Your Lordship and his colleagues, but rather commenting upon some of the recommendations that we have made in this brief.

I would say, if I may, sir, initially that this brief differs somewhat from the traditional kind of brief that the province has presented on matters like this, and perhaps somewhat different from some of the briefs which Your Lordship has received to date.

I would say that we have tried in this brief to strike a rather broad, philosophical approach, if that phrase be apt, to the matters of finance, budget, and so forth in this country, and we hope our observations are broad enough to embrace all of the problems with which the other provinces are faced rather than presenting to you, sir, and your associates, simply something on our own behalf.

The specifics of our recommendations are 15 in all and, if I might, I would appreciate the opportunity of just enumerating those to you and making a very brief comment upon each one of them.

Our first recommendation is that we believe, as the Prime Minister has said, that the basic goal of our economic and financial policies in Canada must be a satisfactory rate of growth. I recognize that is a pretty elementary observation, but I am not satisfied, and I should say the Prime Minister's government is not satisfied, that this is a universally

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held concept -- certainly, universally as far as the country is concerned. We believe it is essential that in Canada we accept the basic goal of our economic and financial policies to be the establishment, the obtaining and the maintenance of a satisfactory rate of growth. We acknowledge that a satisfactory rate of growth is not the only goal, but believe it to be the cardinal goal. There are other goals that we have stated for which we believe our systems must stand and upon which they must be judged, such as full employment, the stability of incomes, equitable distribution of national product, and so forth. But, basically speaking, we believe the basic goal of our economy should be a satisfactory rate of growth.

The second conclusion that we are placing before Your Lordship and his associates on this Commission is this: we believe that if we do accept that a satisfactory rate of growth is the first requisite of the functioning of our economy that our second recommendation is that the Federal Government should state publicly what national goals it seeks to obtain, and should state how in its opinion these goals should be achieved. Until there is an understanding of what the fundamental objectives of legislation and policy are, it is inevitable that we are unaware of whether we are arguing in Canada over the techniques to obtain these goals or over the goals themselves. Whilst we well recognize and accept the argument that different people place different emphasis upon goals, some of which I have mentioned, such as full

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employment, rate of growth, stability of incomes, stability of prices, distribution of gross product in the country, nevertheless, we think that we must establish on a national level and publicly acclaim what the goals of the nation are. We believe that the people in this country are prepared to work hard and prepared for sacrifice, but it is also essential that they be presented with whatever goals this nation as a nation is seeking to obtain. As we have said in our brief, we believe that uncertainty or disagreement in responsible circles about the mix of goals to be pursued is not conducive to the formulation or execution of appropriate policies. We think that on such a statement being made it is easier to discern whether we are debating the mix of the goals themselves or the techniques. But, I think once we accept what the goals are it seems to us it is an easier thing to bring about policies that make this possible. We believe we should strive in this country for an economic rate of growth in the neighbourhood of 4 to 4½ per cent. We think that the national goals should be specifically set forth in the preamble to the Bank of Canada Act.

The third recommendation which we are making to this Commission relates to the Bank of Canada Act and/the Bank Act amendments, and there are six we are proposing. I have brought these together in one place, and the six are these:

We would like to see the preamble of the Bank of Canada Act amended to establish that a

[illegible]
[illegible]
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[illegible]
what the goals of the nation are. We believe that the people in this country are prepared to work hard and prepared for sacrifice, but it is also essential that they be presented with whatever goals this nation as a nation is seeking to obtain. As we have said in our brief, we believe that uncertainty or disagreement in responsible circles about the mix of goals to be pursued is not conducive to the formulation or execution of appropriate policies. We think that on such a statement being made it is easier to discern whether we are debating the mix of the goals themselves or the techniques. But, I think once we accept what the goals are it seems to us it is an easier thing to bring about policies that make this possible. We believe we should strive in this country for an economic rate of growth in the neighbourhood of 4 to 4½ per cent. We think that the national goals should be specifically set forth in the preamble to the Bank of Canada Act.

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satisfactory rate and pattern of economic growth be the chief test of the structure, functioning and policies of our financial and monetary system.

Second, we would like to see the Bank of Canada Act amended to provide a clarification of the relationship of the Government of Canada to the central bank.

Thirdly, we would like to see the Act amended to establish that the decisions taken on the combination of goals of monetary and related policy rest exclusively upon the elected representatives of the people of Canada.

Fourth, we would like to see an amendment introduced to provide that monetary, budgetary and debt management policies cannot be separated from the techniques employed to achieve pre-determined decisions. It is, in our opinion, impossible to separate the responsibilities of government from the responsibilities of monetary, budgetary and debt management decisions.

Fifthly, as the Prime Minister has already said, we would like to see the provinces represented on the Board of Directors of the Bank of Canada. I am not suggesting to you that this means that every province should have a representative. All we are doing is drawing to your attention that we believe that the provinces should be represented on the Board of Directors of the Bank of Canada.

The sixth amendment we would propose is the raising of the interest ceiling under Section 91 of the Bank Act.

I will return to a couple of these observations, if I may, Mr. Chairman, in a few moments, but that assembles in one place the six changes or amendments or additions or deletions we would propose to you in relation to the Bank of Canada Act and the Bank Act.

The fourth recommendation we are making in our brief is that we recommend there be established a national institute for economic research in Canada. Canada has no such institution, whilst the United Kingdom, Sweden, Pakistan, India, the Netherlands and Germany, and so forth, just to name a few, have such an institution. If I may so with great respect, ad hoc bodies, as effective as they have been in certain fields, and as effective as we are confident you and your associates will be in this field, are no real substitute for regular and painstaking research. We believe that in establishing in Ontario an Economic Council and a research branch in our own Department of Economics and Development that we have gone some distance in resolving this problem, but it really is not as effective as doing it on a national basis.

There are three problems which occur to us, My Lord, today that we think demand urgent study, and that they must be done on a national basis by a systematic, regular and painstaking method. One of those is the impact of EEC (the European Economic Community) upon trade in this country.

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The second is the impact of President Kennedy's tariff proposals.

The third one is, or are the specific problems relating to small business.

The fourth that occurred to me was a special export study relating to joint ventures that we feel perhaps is one of the important substitutes for the type of financing of ventures which we now have underway in this country and elsewhere.

Now, these are four very important problems. There is in our opinion no point whatsoever in talking wishfully about the future and about lifting our economy to its highest destiny unless we are prepared to research our problems first and act upon this information.

Now, Your Lordship and his colleagues may come to the conclusion that this is not within your terms of reference, but we believe, sir, that if finance is within your terms of reference for economic growth and stability, then so must be knowledge based on the empirical conclusion and analysis of information.

The fifth recommendation which we make to this Royal Commission is that we urge you to make recommendations relative to the communication of all available information between segments of the economy and our political institutions in Canada. We believe that there are some sectors of economic life which suffer today from disabilities which stem basically from the lack of communication and the lack of information. We think that they are, for instance in

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the case of small businesses and some certain segments of our economy, suffering from the lack of information and ignorance and sources and methods of financing. We think that many problems have arisen in a sector of our economy. I do not have the figures in front of me, but I think it is worthwhile noting that I think the D.B.S. says that -- is it 95 or 85 per cent -- 85 per cent I believe of most of businesses -- 90 per cent of businesses in Canada can be classed as small businesses.

Now, there are some people who believe that we have given too much attention in this country to small businesses. I do not happen to be one of those people. Neither is the Treasurer or the Prime Minister. We believe that this is a very important area of development.

We also believe that one of the characteristics of a dynamic society, a growing society, is the number of small businesses there are. We think they suffer at the moment from a lack of information quite apart from the lack of financial assistance to which we will make reference a little later.

I might just say in concluding that single point that our brief deals with this more effectively than I am able to, or as I have dealt with it today, sir, but we are anxious that you bring this point home to those who can act upon your recommendations, and those who will be influenced by them, because it may very well be that what is needed is a broader and improved base of communication rather than to change

the size or number of our financial institutions.

Now, the sixth recommendation that we are making to the Royal Commission is this. We are asking you positively to emphasize the importance of the investment that is made in human capital in Canada.

We believe in Ontario that a dollar invested in human capital produces the same kind and the same size of dividend as a dollar invested in physical capital and, in fact, from the studies that have been carried on in the United States relative to this equation -- there are many worthwhile published works which evidence that in the United States this is true -- we believe it to be true here. We are asking you in emphasizing the importance of the investment of human capital to relate the investment to the investment of physical capital but not to subordinate it to it.

We hope that in your conclusions, your preamble or your observations that you will draw emphatic attention to the importance of improving our educational systems and the importance of training and retraining the labour forces, and the effect that human capital investment has upon the strength, the stamina, the mental health, the vigour and vitality of the nation.

Our seventh recommendation deals with somewhat the same aspect but we base it in this way; that since welfare and education are the chief responsibilities of the provinces and the municipalities, we urge you to give the greatest emphasis to the kinds

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Our seventh recommendation deals with somewhat the same aspect but we base it in this way; that since welfare and education are the chief responsibilities of the provinces and the municipalities, we urge you to give the greatest emphasis to the kinds

and the reliability of the tax resources and the credit requirements of the provinces and the municipalities.

One of the fundamental points that we are anxious to make to you is this, and it is I am sure not new, but, nevertheless, in relation to the provinces and the municipalities which have a very large investment in the human capital of this country, they have not the same kind of flexibility as do have industries or the federal government. We have a kind of built-in and ever-enlarging responsibility because once a child enters into the school system at age five he is our obligation until he is aged sixteen or higher, and tight money or no tight money, we have to care for him.

Now, this is not necessarily true in relation to industry, and it is not necessarily true in relation to many of the obligations of the federal government. So, we say unto you that we are very concerned about the adequacy of social overhead capital available to the provinces and municipalities.

Whilst we have not included many facts or figures in our brief, I would be obligated to you gentlemen if you would bear this in mind as to our own province alone. These are figures which I think show the startling responsibility which we have in our province to accept. We are not saying we are in a different position than any other province. We are only able to speak on our own behalf in this connection.

We have today in our elementary and secondary

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schools 1,462,000 children -- roughly 1½ million. Now, in an eight year period we are going to have an increase of over 350,000 pupils. This will come somewhere near 1,800,000 pupils in an eight year period. This means more teachers, more schools, more teachers' colleges, more books, more classrooms and more everything that goes with it for 400,000 or 300 and some odd thousand more pupils. This is a very staggering amount for any province to assume.

May I just say to you that in 1961 the province of Ontario paid to the school boards $181 million, and in 1970 we expect to be paying $400 million a year.

Now, that $400 million, My Lord, does not include the cost of teachers' colleges, university grants and a number of other expenditures. That is in respect of education.

In respect of health, and this is the last statistic I will be giving you I hope this morning, we are paying for hospital services out of the provincial Treasury in 1962 $52 million in Ontario. In 1965 -- that is three years hence -- this figure is going to be $100 million. These are two of the built-in inflexible kind of expenditures in which we are involved.

We believe that public expenditures on health and education in total, as a total of the national expenditure, is going to increase in the coming years.

I am sorry, I have one other figure. The gross national product in the last ten years has

gone up by 120 per cent, and federal expenditures have gone up 162 per cent, but Ontario expenditures have gone up 218 per cent.

Now, the Prime Minister, and I do not need to comment on this, has indicated what he has undertaken in the province with reference to an investigation of the tax responsibilities and resources of the province and the municipalities.

He has also said that he regrets that this is not a nation-wide movement because we are only really dealing with half the problem.

The federal government is well lodged in the centre of the road in terms of financing and budgeting and, therefore, for us to investigate it on a provincial basis is only half of the problem. We are sorry that it is not being done on a federal basis, but it may be that in these representations to you and what flows from them, namely, your conclusions, some attention can be given to that aspect of the matter.

As I have said to Your Lordship and his associates regarding these expenditures of ours in these fields alone, we cannot turn them on and turn them off, they are steady, they are built in and they are long term.

Now, in this connection also, and perhaps it has already been referred to sufficiently -- I do not want to overdo this matter, but it is a very important problem to all of the provinces and the municipalities -- we cannot depend for these things

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on contra-cyclical budgeting on the federal level, nor contra-cyclical financing, monetary or other fiscal legislation, policies, resolutions, or whatever they may be. We believe there is a greater need, or in any event there is a need for greater amount of consultation between the federal government and the provinces as to the provinces' and municipalities' needs contained therein.

When a province has this problem, when there is insufficient revenue, it has to turn to borrowings, and most of our borrowings are over a long term and, therefore, on a long term basis and interest becomes a very big item. This is not necessarily so in respect to companies or others that can borrow on a 90-day, 365-day, or even a 5-year basis. Industry does not take that ominous burden on itself which the provinces and municipalities do, having to borrow on a long-term basis.

Now, Your Lordship, I have, therefore, set forth at page 19, the suggestion, about the middle of the page, to you that in formulating proposals for changes or reforms in the techniques and policies of monetary control your Commission should bear in mind the following considerations among others:

(a) the likely contribution of the various sectors of the economy to sudden inflationary or deflationary pressures.

The preamble to that observation is that there are certain elements in our economy which contribute more than others to inflation or deflation, yet

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The preamble to that observation is that there are certain elements in our economy which contribute more than others to inflation or deflation, yet

they are all punished equally when the block falls; when tight money or whatever other programme comes in. This is because we do not have sufficient selective controls, nor is our banking or finance system in our opinion sufficiently flexible to deal with these things.

(b) The speed and effectiveness with which the various sectors respond to changes in credit policy, --

-- and I draw to Your Lordship's attention that organizations such as private companies can respond pretty quickly to changes in credit policy, but when you have heavily built-in expenditures such as we have in respect of our health, welfare and education, it is obvious these things respond very slowly.

We ask you to give special consideration to the speed and effectiveness with which expenditures in various sectors are able to recover when a policy of tight money is relaxed. I am going to suggest to Your Lordship a little later on one of the elements of our economy which does not recover perhaps at all, and that is the export trade.

(c) We ask you to give consideration to the need in pursuing policies of stabilization of prices, employment and incomes, to avoid discouraging or otherwise unduly affecting the long-term prospects, and development of those sectors of the economy which constitute the core and basis of any policy of growth.

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mendation.

The eighth recommendation is one that the Prime Minister and I have already mentioned, namely, we believe that provision should be made for provincial governments to be represented on the board of directors of the Bank of Canada. I want frankly to say this to you, as we read the record our long term economic and social development has not infrequently been sacrificed to ill-conceived and ill-timed stabilization measures undertaken by federal governments and others. We believe our monetary system and policies tend to discriminate against investments in social capital entrusted to provincial and municipal governments and in favour of public expenditure under federal jurisdiction. This is why we feel, not only in the sense of equity, but of even development in this country, that there should be provision for representation of provinces -- we are not talking about Ontario, we are talking about all the provinces -- on the Board of Directors of the Bank of Canada.

Now, the ninth observation or recommendation that we want to make to the Royal Commission today breaks itself down into two parts: if I may call them 9 (a) and 9 (b).

We are asking Your Lordship and his colleagues to give special consideration to the importance of small businesses. That is 9 (a).

9 (b) we urge that fresh attention be given to the specific problems of small businesses as well as their need for medium and long-term financing.

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9 (b) we urge that fresh attention be given to the specific problems of small businesses as well as their need for medium and long-term financing

Now, I think perhaps part of this is slightly redundant and if it is they can be put together, but we are very anxious that the report of the Royal Commission emphasize, highlight, sparkle with a concept of small business and that it give special emphasis to the problems of small business, and that it treat as a separate item the problems of medium and long-term financing of small businesses.

Now, if I may just say this to the Royal Commission, in Ontario 50 per cent of our labour force is in businesses employing 15 or fewer people including self-employed. 8,000 of our 13,000 manufacturing organizations in Ontario employ 15 or less people. I have said already that a cardinal characteristic of a dynamic society is the number and increasing number of small firms. They do not have to be small but this is one of the characteristics of a growing economy. Small businesses are very important to us and to Canada, we believe. They represent a number of great opportunities which, without them, perhaps would not exist. It may be, and we believe it is so, that the tendency today is that people may not want to save for the future, but that they might be prepared to make a down payment today with what they have.

This is one of the attractions which small businesses offer to people. Secondly, only a small business can be supported in a small town. We have many small cities and towns in our country -- not just in Ontario, but in our country as a whole. We are doing what we can in Ontario to bring about certain types of decentralization, not only from a social standpoint but also from an economic standpoint, and certainly one of the key ingredients to a policy of decentralization is small business. We do not think there is any better defence of the social fabric and pattern of life in Canada which we treasure so highly than the encouragement of individual ingenuity and drive, as evidenced in small business. In our brief we discuss with you these and other aspects of small business.

Now if I may turn to 9(b) for a moment and discuss some of the problems, as we see them, of financing medium and long-term for these small businesses. The progressive income tax has made it virtually impossible for small businesses to finance themselves out of savings or earnings. Secondly, investors in Canada incline to invest in what one might call "blue chip" investment rather than in small businesses. A third point I think worthwhile considering is that most of the borrowings of small business -- the largest proportion -- are in the field of medium and long-term. The small businesses have difficulty in financing themselves. They do not have a long or a good record, or they may be just starting, so they have no record at all. Their revenues are

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not stable; they have little experience. There is no continuity of leadership, and they have no credit rating.

We believe that the measures which have been taken since the end of the war to deal with small businesses have been inadequate, such as the Small Business Loans Act, the Farm Credit Act, and the Industrial Development Bank Act.

I should like to say one word, if I might, about the Industrial Development Bank. From 1944 until 1961 its average yearly loans were $22 million for the whole of Canada. This, in our opinion, is grossly inadequate, and in our opinion the caution (if I may be excused such comment, Mr. Gibson) of the Industrial Development Bank has incautioned and out-banked the bankers.

We think, My Lord, that it is necessary for a re-definition of the Industrial Development Bank. We think we have to decide what is the Industrial Development Bank standing for. Does it stand for aid to small business? Does it stand for regional development? Does it stand for industrial development in less wealthy provinces? I think the Bank has tried to bring about a mix of all of those. It may be that that is the desirable way of handling their business, but fundamentally the fact that seven provinces have had to establish their own agency, and that Ontario is now considering such an agency, is I think indicative that the Bank has not lived up to the heralded purposes for which it was

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thought at one time, or perhaps is thought now, to stand. We also believe that the Industrial Development Bank is an adjunct to the Bank of Canada and that it is going to reflect the banking concept of this country as opposed to a development concept.

Lastly, in terms of small businesses we believe that there should be something established in Canada to give advice, technical assistance, and so forth, to small businesses. We are establishing in Ontario a small business branch in the department which I have the honour to represent here today, but we think that something should be done on a national level.

The tenth recommendation that we are proposing to the Royal Commission is that we urge all institutions extending consumer credit be required to declare on a comparable basis the effective rate or range of rates of interest which they charge consumers. I do not think I need say anything more about that. We state our case on page 30 of our brief in that connection.

Our eleventh recommendation is that the Small Loans Act be amended, and the reasons we give are contained in paragraph 89 of our brief. They are fairly simple, but I am sure they have already been drawn to your attention.

Our twelfth recommendation deals with the amendment of Section 91 of the Bank Act. There are maybe many reasons for amending this section, which would raise the ceiling of interest rates that

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banks can charge, but three that we would propose are that interest does not ration loans during periods of tight money because of the ceiling. The ceiling does not do this. We believe that historically the ceiling, secondly, was put on because at one time banks had in effect a monopoly as to lending in this country. They do not any more. Clearly with the trust companies, the mortgage companies, the other finance companies, and so forth in the field, the banks have no monopoly, and our people are sufficiently aware of the services available in other institutions. Thirdly, we believe that the ceiling restricts the savings interest rate, which discourage savings when savings may most be needed. However, these reasons and others we have set out in the brief.

My Lord, there are three other recommendations I want to put to you, if I might. Our thirteenth recommendation asks specifically that you put a greater emphasis, or a considerable emphasis, on our export trade, and to that end we are hopeful that in your report you can suggest that more effective steps be taken relating to tax incentives, export credit guarantees, and other methods which can stimulate exports. Our view is that whilst exports are talked about in many circles, perhaps they are not sufficiently understood and that we have a very long way to go if we are to obtain what is essential in this country, namely, a balance of our international payments. As a part of this, My Lord, we are asking the Royal Commission to further recommend steps which

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might be taken by the Federal Government to stimulate companies in Canada to manufacture in Canada goods which are now being imported into Canada in very large quantities.

It is arguable what importance export business of a country has as a percentage of its national income as it develops, but we believe that it is very important. We believe it is not only important to hold the markets we have, but also to expand them.

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I think it is quite clear that a great deal of the domestic demand for domestic production has been stimulated and is maintained because of consumer credit.

We believe that we are approaching an era in international trade where the same thing is true; that we have been living in an era of untied international commercial relationship, and ~~are~~ now entering into a new field, entirely new, and that until its significance is thoroughly grasped, we cannot undertake, I do not think, nationally policies which will grapple with the export problems we have. That is to say, we are entering a period now where credit and the product go together.

Now, private industry is able itself, perhaps in some of the primary exports, to handle credit problems until you come to deal with some of the countries dominated by the communist regime. We cannot overlook this either, because one-third of the world's nations, people, populations and their capacities are dominated in this way. Today credit is becoming a condition of sale. We are hoping that you may find ways to recommend how private companies can pool their risks and pool their resources to offer credit.

We are also hoping that you can suggest ways and means in which the federal government can induce private companies to give export credit. But we believe that even if these two are brought about -- namely, private companies pooling their resources

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to give export credit, and the federal government offering inducements to private companies to provide export credit -- there will still need to be an alternative to these.

In this connection I might say, Mr. Chairman, that it will be necessary, we believe, that some special consideration be given to the export problems of small businesses. They are small businesses. They deal in small orders, of an order of under $100,000, and these are difficult for them to deal with. I want, if I may, in concluding this one point, to say this, My Lord, that exports cannot be turned on and turned off. And exports can suffer very heavily at the hands of an axe, being hewn away in the interest of tight money. It takes a long time to develop export markets, and they may be destroyed through lack of service, lack of credit, lack of deliveries very quickly. This is why we advocate to you that selective money control and greater flexibility are needed in our economy if we are going to cope with our export problem.

The fourteenth recommendation that we make to you, generally speaking relates to foreign investment in Canada. We hope that you will give special emphasis to foreign investment in Canada. We hope that you will clarify its advantages and its disadvantages. We hope that you will analyse what some of the future needs of this country may well be in relation to foreign investment. Because we believe that the development of this country is going

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to depend upon foreign investment in the future. We believe that the stability of the Canadian dollar will depend in part upon foreign investment. We are hoping that you will set straight the record in relation to the advantages and disadvantages of foreign investment. And we hope above all things that you can urge the federal government to state a long-term policy in relation to foreign investment in Canada. One day it is welcomed and one day it is damned. This is not something which we think is in the best interests of the development of this country.

We have set forth in our brief an enlargement of this problem, but it is gilding the lily to discuss it further with you, other than to say that as we advance into this decade and into the balance of this century, so much of it will depend upon a very competitive world market and our capacity to meet it. We believe that we are going to need a considerable amount of foreign investment in this country, and we think that it is worthwhile that this is so. We wonder whether Your Lordship and his colleagues would feel it wise to point out in your report that foreign investment, in terms of bonds of municipal, provincial and federal governments, gives no control to the foreigner; whereas investment in equity stocks does do so, and it may be the greatest accolade the country could ever hope for is to have foreigners prepared to finance the education and health of our people by buying debentures

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from our governments, from which educational and health facilities are constructed and carried on.

Our fifteenth recommendation is a simple one, and I think it is inherent from what the Prime Minister has said. We are recommending the present withholding tax on provincial and municipal bonds be abolished.

Now, I want to thank Your Lordship for your indulgence in hearing me. I have been longer than I had intended to be, but we believe very sincerely in the programmes which we have put to you. We could have outlined the type of background and functioning of the financial and monetary system in Ontario. We do know that you have carried on extensive studies in our department and that you have done much research in this field. Therefore, we have tried to limit our observations to general observations, which we hope will be helpful in the development evenly of this country as a whole.

I have with me on my far right Mr. Hickey, who represents the Department of Municipal Affairs. Next to him is Mr. Brown, the Deputy Treasurer of the province of Ontario. Then there is the Treasurer, Mr. Allan. Of course, the Prime Minister is on my immediate right. On my left is Mr. Clarkson, Deputy Minister of Economics and Development. Mr. Stevenson is next to him, and he is the Director of the Economics Branch in the Department. Then there is Professor Triantis, who has given us very valuable support in the preparation of our submission; and Mr. Richmond is the Assistant

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We are very anxious now, if we can, to assist you in any way by answering any questions which we may be capable of answering. I would just close by saying that the facilities of our Department, all of them, are open to your staff, and if there is anything at any time later on that we can provide, we are most anxious to do so.

THE CHAIRMAN: Thank you very much, Mr. Macaulay. Are there any further statements?

PREMIER ROBARTS: No, sir.

THE CHAIRMAN: Then we will proceed with the discussion. Mr. Gibson?

COMMISSIONER GIBSON: Mr. Chairman, like the other Commissioners I find the brief of the Ontario government very interesting; and, in addition, the remarks of the Prime Minister and Mr. Macaulay have done quite a bit to bring it into focus and to put emphasis where they particularly wish to put emphasis.

I should like to start by asking a few questions about the opening section of your brief, and that is the section dealing with your goals with regard to economic and financial policies. You list these goals roughly as follows. The first and prime one is a satisfactory rate of economic growth. Then you list full employment, stability of income, equitable distribution of the national product. Then as rather secondary conditions to the obtaining of these objectives, you list stability of prices, economic flexibility, and a reasonably balanced international

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economic trade position. I take it that these are your views of the appropriate goals for economic and financial policy. Would you say that any of them were particularly the goals of monetary policy, or would you make any distinction? I do not know to whom I should address the questions.

MR. MACAULAY: I think we will all take a whack at it, if we may do that.

MR. CLARKSON: Mr. Chairman, of course we have gone behind in this question, I think, the matter of monetary or fiscal policy in the preparation of this, getting right back to the fundamental things we should be shooting at. We felt that in this case we should state these as a prerequisite of everything else. In answer to your question, I do not think it does tie in specifically with monetary and fiscal policy, but it should be behind it.

COMMISSIONER GIBSON: You would not go along with the view which we have heard from certain European experts in this matter, that price stability ought to be the particular objective of monetary policy?

MR. CLARKSON: I think Mr. Stevenson may help here.

MR. STEVENSON: I should like to say that while the goals we have listed refer to economic and financial policy generally, the question of prices, of course, comes particularly within the purview of monetary policy.

Also, I think the purpose of this brief was that monetary policy, through its action in the monetary system, would support the general goals of the economy and of economic policy, and that price stability is naturally the goal of the monetary system and of monetary policy.

COMMISSIONER GIBSON: Would you think, in thinking of monetary policy as such, as a branch of general economic policy, that price stability would be one of its prime objectives?

MR. STEVENSON: Yes, in so far as it fitted into the over-all goal of our economic system.

COMMISSIONER GIBSON: Well now, in looking at economic growth, your Mr. Macaulay has said with respect to this idea that you would think in terms of a 4 to 4½ per cent increase per annum. Is that growth in the national output of goods and services, or is it per capita output of goods and services that you are thinking of?

MR. MACAULAY: Actually, we were thinking when we stated that -- and if I may, my father always says, "I wish whenever I ask you a question you wouldn't give me a speech", but my problem is that I have to go back on this. In Ontario we have 60,000 people coming on to the labour force each year. In Ontario we believe that it will not be possible for us to handle these people in our economy unless we have a rate of provincial product growth of some 4 to 4½ per cent. We are talking in terms of constant dollars and in terms of the Gross National Product.

[illegible]

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COMMISSIONER GIBSON: But you are talking in terms of the use of the growing population; you say it is the actual annual constant growth?

MR. MACAULAY: Yes.

COMMISSIONER GIBSON: Not the growth per capita?

MR. MACAULAY: Yes.

COMMISSIONER GIBSON: Well now, when you think of growth as a concept, you are just thinking of the sort of average increase and the output of all goods and services, or do you put particular emphasis on production of goods? You have said, for example, that you do put particular emphasis on the production of educational services, which is good, that is a service that is in your economoy, but it is one of the problems in looking at growth to know just what one means by it. Is it just whatever basket of production comes out of the machine or do you put emphasis on particular aspects of it?

MR. MACAULAY: Well, it is very difficult, sir, as you well know to have any yardstick by which you measure these things. I think they are a pretty rough thing anyhow, and the Gross National Product and the income are two yardsticks by which conventionally one measures development normally, and I don't know whether I am answering your question when I say this, but we put particular emphasis upon the growth of secondary industry; we put particular emphasis upon the human capital to service this secondary industry, because one of our problems is the question

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of the employment usefully of our people as an aid to the development of our state, and that if their employment is a very large factor to us and we conclude that in the primary industries, such as pulp and paper, mining, agriculture, we simply cannot find a place for these people who are coming on to our labour market, much less those who are now unemployed, therefore it is the secondary industry which we are looking to and it may be that the greatest emphasis will be either in that or in those things which are essential to service that.

MR. STEVENSON: And I might add one thing; I think in the Department we have been considering that it is perhaps in the field of secondary manufacturing that in the next few years the greatest problems will be faced because of changing patterns, and therefore particular emphasis will have to be laid so that secondary manufacturing can adjust to this situation, and it may require greater than proportionate investment.

MR. MACAULALY: This may not be directly on your point but, as I understand it, we are able to sort of discuss our way around these problems, and this is why I mentioned in relation to a national research institute that we are greatly concerned, quite naturally; we are not taking an insular point of view about the Canadian proposal in relation to trade.

We have in our province, for example, some 5,000 manufacturing concerns that are subsidiaries

of United States parent companies, and this influences our capacity to export for reasons which we don't need to go into here, but it also is quite clear that many of these companies have established in Ontario so that they can get over the hurdle of tariffs and to obtain the British preference. If the European common market embraces Great Britain, then one of these reasons goes and if the tariff goes, we are faced with some very serious problems; not ones which we are not prepared to face, because I think this is the trend today, but nevertheless this is true.

COMMISSIONER GIBSON: This is the sort of comment that I was hoping you would give. Growth as a general idea can be pretty vague unless we have some idea of the kind of economy you are looking for.

MR. MACAULAY: Sir, you say that we have put emphasis on the investment in human capital, and this is correct, and this is why we have mentioned to you the importance of training and re-training. We were trying to get the best out of our money in this field and to find out how much more will be needed, and this would apply in the field of education and training and re-training, and the kind of human investment that is necessary to keep our people in good physical condition, mentally and physically, so that they can do a good day's work, and these are the things that will be as essential as creating new secondary opportunities, and these things will go together. You are asking us in depth, perhaps,

something which we should have been prepared to give you something more definite on.

COMMISSIONER GIBSON: Well, really, in my mind growth is a means to an end, too.

MR. MACAULAY: Yes.

COMMISSIONER GIBSON: And I suppose the end is broader opportunities for the people living in a particular area and a high level of employment and greater welfare and standard of living, and so on, but you would say that the growth was the best way to emphasize and achieve these kinds of ends?

MR. MACAULAY: Yes, and I think we are suggesting that while you can have stability of prices in a non-growing community, and you might even have an even distribution of opportunity and income and production in a stable economy, that is, a stationary economy, but there are some things, however, you cannot have with a stationary economy; you can't give employment with a stationary economy to a growing population so, in short, what we have said is this, that all of the objectives which we are seeking, in our opinion, depend partly upon -- and some rest solely upon -- the rate of growth.

COMMISSIONER GIBSON: You see the objectives, which is also a means to an end of stable prices, as being seriously or frequently in conflict with the objective of growth?

MR. MACAULAY: There again, you see, it depends on your emphasis. For a person who is 65 and living on a fixed pension, stable prices may be

[illegible]

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MR. MACAULAY: [illegible]

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right at the top of the list, but somebody who is 21 and just coming out into the business world and with his future all in front of him,

it seems to me that that person isn't as concerned about rising prices. It depends to a large degree upon whose ox is being gored, which is the phrase.

COMMISSIONER GIBSON: I appreciate that, but many people take stable prices much more seriously than others. Do you think that this objective is seriously in conflict with the objective of a satisfactory rate of growth?

MR. MACAULAY: I don't know what you mean by "in conflict"; are you saying it is hard to obtain them both?

COMMISSIONER GIBSON: I am asking you what you think about that?

MR. STEVENSON: We do say in the brief that on occasion growth cannot be obtained without the sacrifice of some loss in stability of prices, and that if as you say growth is perhaps the supreme goal in most situations, perhaps the situation Canada might find itself in if it were fairly stagnant and there was not too much prospect of increasing job opportunities, then it may have to be at the sacrifice of some price increase that we would obtain this rate of growth.

COMMISSIONER GIBSON: Well now, this would be in a certain set of circumstances where possibly there is a very strong external demand or prices are

right at the top of the list, but somebody who is 21 and just coming out into the business world and with his future all in front of him.

It seems to me that that person isn't as concerned about rising prices. It depends to a large degree upon whose ox is being gored, which is the phrase.

COMMISSIONER GIBSON: I appreciate that, but many people take stable prices much more seriously than others. Do you think that this objective is seriously in conflict with the objective of a satisfactory rate of growth?

MR. MACAULAY: I don't know what you mean by "in conflict"; are you saying it is hard to obtain them both?

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COMMISSIONER GIBSON: Well now, this would be in a certain set of circumstances where possibl there is a very strong external demand or prices are

up a bit, but taking a longer view, do you think there is very much conflict in these objectives? There will be times when prices go up and times when they are a bit weak, as they have been in the last few years. What is a tolerable long-range increase in the price level to be acceptable and consistent with your goals of growth? Do you think any long-range increase is tolerable?

MR. MACAULAY: I think some is tolerable -- and we have mentioned this -- we think the stability of prices is something that is going to come about or not come about as the result of growth, but I don't think we would ever sacrifice it, and furthermore, I think ---

COMMISSIONER GIBSON: Never sacrifice growth for stability of prices?

MR. MACAULAY: No.

COMMISSIONER GIBSON: And you wouldn't put too much emphasis on it?

MR. MACAULAY: Frankly, my own view would be that.

COMMISSIONER GIBSON: I see.

MR. MACAULAY: Have I upset the brief? We have quite a democratic way of preparing this brief.

COMMISSIONER BROWN: I wonder if I might ask a question on this. In your objective of a stable rate of growth, a satisfactory rate of growth, you will require stable investment, and this is going to be an investment in fixed income securities for both

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COMMISSIONER BROWN: I wonder if I might ask a question on this. Is your objective of a stable rate of growth, a satisfactory rate of growth, [illegible] -- be an investment in fixed income securities for [illegible]

provincial and municipalities. Now, you are prepared to sacrifice stable prices, but how will this affect your ability to attract that type of investment?

MR. MACAULAY: I don't think we are talking, Mr. Brown, of runaway prices; I think Mr. Gibson was trying to come down to the point, or got us to the basic point which we put ahead of the other, and I think we consider this important in that we have emphasized the attraction of foreign capital into this country. I think that it is obviously very important to the people who hold bonds and who buy them that they will be very interested in relative returns on their investment as well as the price of goods which they buy. I don't know that I can say to you how does the one affect the other. I suppose one is a depressive of the other.

COMMISSIONER BROWN: Which is which?

MR. MACAULAY: Well, I would think if prices got out of hand -- as in some of the banana republics -- I would think the tendency would be to discourage foreign investment; to put it in a sock, to bury it in the back garden, get into gems, diamonds and nicotine, so obviously if we carry it to an extreme this may be a bad thing for your state, but we are not talking in terms of extremes.

COMMISSIONER BROWN: Mr. Gibson was trying to get at what terms you were thinking in.

MR. MACAULAY: We are trying to get away from him!

COMMISSIONER GIBSON: We have had it suggested

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MR. MACAULAY: We are trying to get away [illegible]

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to us that declining prices were definitely in conflict with a reasonably long range rate of growth, but we have also had it suggested, and strongly, that prices advancing more than slightly over a long period are also in conflict with a satisfactory rate of growth, so maybe the thing is not by any means clear, and there are a lot of different opinions which we have heard.

MR. MACAULAY: Don't you think it would depend on how other things advanced? That is to say, if your Gross National Product grew at the expense of an increase in price, then you really perhaps have had no real increase in the Gross National Product, and that is one of the problems, to sort this out.

The first time I ever heard of a "constant dollar" is when His Lordship started talking about it about eight years ago. I was going to ask him if he wouldn't mind lending me a constant dollar, because there just are not any around, but a lot will depend on whether it will take self-sacrifice or growth to obtain it and, another thing, rises in prices I don't think are noticeable if everybody else's prices are rising; that is to say, in other jurisdictions, so whether you are talking about an absolute rise in prices or a comparative rise in prices in a nation only, it is another matter. What about you, Professor?

PROFESSOR TRIANTIS: If I may come into the discussion, I don't say that what I mean to say is academically proven or can be proven, but if you look

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PROFESSOR TREMAYNE: If I may come into the discussion. I don't say that. What I mean to say is [illegible] proven or can be proven, but if you look

at the statistics of European countries since the end of the war and you examine their rate of growth, number one; the percentage of unemployment, number two and the yearly increase in prices, number three, and you say that these are your three goals which may be expressed numerically, you will find that the countries which are supposed to have done well are the countries where the rate of growth, the growth in the over-all product, is greater than the sum of the rate of unemployment plus the rate of increase in price, so if we could get something like $4\frac{1}{2}$ per cent growth and have a 3 per cent unemployment and a one per cent rise in prices, then I would say we are doing well.

You will find countries like Japan and Germany have done much better; that is, the rate of growth has doubled the sum of the rate of unemployment and the increase in prices, and you still find countries in North America doing worse. This cannot be proven academically, but it could be national.

COMMISSIONER GIBSON: It depends on the periods. In the period of the last few years what you said would be so, but if you took from the end of the war you would see a better picture in North America?

PROFESSOR TRIANTIS: In the 1950's that is the picture. However, as far as Canada is concerned, I would say that if you go to the market and you come back with an empty basket, you are getting worried as to what should be in that basket and that is the

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state in North America today. If we have no growth, we are worried about growth. We are prepared to look at prices, but it is a secondary consideration, and this applies also to the content of your growth. I don't know whether that represents the view or not. It is what this $4\frac{1}{2}$ per cent should be, whether education, or what.

MR. MACAULAY: That gets back to Mr. Gibson's point.

PROFESSOR TRIANTIS: I should say that this depends on what growth is leading to. If it is leading to difficulties in the international field, the aim of your growth should be more education, more science, more technology, and so on. If we are sure about our ability to defend ourselves, growth is a matter of having good times, but it all depends on what it is we want.

COMMISSIONER GIBSON: I think that Mr. Macaulay put a little more specific objective on it from the Ontario point of view, and the emphasis of secondary industry would fit into this. I don't know whether we should ask you to express a view on the international situation.

MR. MACAULAY: We are feeling sufficiently inadequate on the subject which we are asked to express ourselves on without getting into that!

COMMISSIONER GIBSON: One of the other objectives which I found very interesting, when this was put on the secondary list, was the financial system that is conducive to a flexible economy. I

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wonder if you would devеop this a bit? Should there be more changes in interest rates?

MR. MACAULAY: Well, I think that that is contained -- the juxtaposition of this is more by misadventure than anything. I think we have felt that the aegis by which these things would be brought out would be a flexible economy; I don't think we are putting that sort of last and least. Isn't that so?

COMMISSIONER GIBSON: I wasn't suggesting that; I wondered what your thinking was, how you think the financial system could be improved and made more conducive to the economy?

MR. MACAULAY: I would say that indirectly we pointed out to you that the blanket application of tight money, for example, is destructive in the export business, whereas it might be a very good thing in certain other aspects.

We think that the application of tight money, as a policy, hurts some people and doesn't hurt perhaps others, and yet that is why we asked you -- urged you, rather -- to find who are the bad boys in the house that cause the inflationary pressures, so that we might give them a pat on the wrist, as opposed to just sort of saying, as my parents used to say, "I am tired now; we will all go to bed."

COMMISSIONER GIBSON The system just works that way?

MR. MACAULAY: It may be that you are correct, it may be that; I am certainly not going to

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COMMISSIONER GIBSON: The system just works [illegible]

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delineate it for you.

COMMISSIONER GIBSON: Well, on this question you mentioned tight money, and your argument is quite correct, that tight money affects some of the smaller operators who find it difficult to get ahead the way they otherwise would have, but on the other hand, it has frequently been argued that tight money tends to cut costs down and maintain your export position. There is a conflict here.

MR. MACAULAY: When you say that it has been argued, this assumes you are talking about a past record. I was trying to suggest to you that we were emerging into a new era of tied transactions in the export business where credit is an associate characteristic of the transaction. If that is so, tight money can, and I suspect will, have a much more disadvantageous effect in the future than it has had in the past on the export business.

MR. STEVENSON: I think particularly in Ontario now the emphasis is on trying to get some small manufacturers particularly, who may not have been in the export field before, to enter this new field. These are firms which may have much more trouble getting money, particularly when money is rather tight, and therefore their attempts at holding or breaking into the new market may be more seriously affected than a larger firm.

COMMISSIONER GIBSON: I would like to ask you about your recommendation that there be an announcement of goals: this would be presumably by some organ of the federal government, I take it from time to time, of the goals of economic policy and the particular mix that suited circumstances; is that a fair statement?

MR. MACAULAY: Yes, sir.

COMMISSIONER GIBSON: Would you say a little more about this? Would you envisage this being done once a year, or whenever it was appropriate?

MR. MACAULAY: "Whenever it is appropriate"

is a matter of judgment. This is obvious, I think. But, I would not want to tie it down to every year. Frankly, what we had in mind was something on a longer range basis than that. We are involved in the province, under the Prime Minister's direction, in bringing about a number of results: we are hoping to do something effective in the field of import replacements, something in the field of greater exports, decentralization, the creation of new industries, and so on. We know from having worked as hard as we have in the past nine months that it is only now starting to show. Therefore, I think it is fair to say that any kind of pronouncement would be on a long range basis, and I think we had in mind, although I hate to use it, a five year plan sort of approach.

COMMISSIONER GIBSON: This would be an announcement of the basic goals which you outline in the brief of national economic policy, and the emphasis which was to be put on each?

MR. MACAULAY: Yes, sir.

COMMISSIONER GIBSON: I can understand a general statement of this kind, but as soon as you start getting down to particulars, would you say, for example, we should put up with a certain amount of increase of price every year if the circumstances suggested this, or would you be silent on the subject?

MR. MACAULAY: I think I would be silent on it, myself.

PREMIER ROBARTS: I think the idea is that there would be a basic goal which everybody would

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PREMIER ROBARTS: I think the idea is that there would be a basic goal which everybody would

understand we were getting to. I think this really is the concept of the idea. Of course, the degree of particularity with which you can do that, and the frequency with which you can make statements -- because frequency of statements would indicate alteration of objective -- there would be no purpose in making any statement unless you had, in fact, changed your objectives. I think the basic concept is that we would know what we were striving for so that the efforts of all could come together in a common purpose. With that in mind it would have to be reasonably broad and could not be revised every six months.

COMMISSIONER GIBSON: This would be a long-range economic programme in which you name a certain rate of growth or a certain balance of payments -- is that the kind of thing?

MR. MACAULAY: I think so.

PREMIER ROBARTS: Some you could put in the language that economists might understand, and some you could put in the language that businessmen might understand, and some you might put in the language that people generally would understand. So, there would be some idea of what, in fact, we were attempting to do.

MR. MACAULAY: We feel, and it may be that price increase -- although I did not have it in mind as one of the sacrifices -- I think the burden of our argument is that the best organ of democracy is a well-informed public. We believe, so long as people in high places are debating amongst themselves as to what

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we are trying to do and what route we should take to do it is unsettling to a public which otherwise might be prepared to make the necessary sacrifices. I do not say necessarily high prices: let me give you an example, if I may be so bold: I think the public of Canada accepted what was called the austerity programme with very good grace. Whether "grace" is the right word, I don't know. Let me say that it had a high degree of acceptance. People felt, I think, that it was necessary and nobody had ever told them this before. If they had been told before, I think they would have done it before. I think they would make even greater sacrifices. In what area, I don't know just at the moment that I would be prepared to say, but I have a great belief in the human nature and the well-being of our people and I am confident our people will make the necessary sacrifices, but they have got to be taken into the confidence of those leading the country, and they have to be convinced that those leading the country know where they are going. I don't know exactly what statement we had in mind, but we sort of had in mind the kind of signals that are played in a rugby game. There would be chaos if everybody had a different play, and we think this is about the way things have been going.

--- Short Recess.

COMMISSIONER GIBSON: Mr. Chairman, I would like to ask one further question in this first section of the Ontario brief. It relates to the

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[illegible] like to ask one further question in this first [illegible] of the Ontario brief. It relates to the

relations between the federal government and the central bank.

You make the statement very definitely that the relationships should be clarified by the statute that the decision on the combination of goals of monetary and related policies rest exclusively upon the elected representatives of the people of Canada. How would you go about this? I understand what you are saying, but how should these relations be outlined? Would you think of changing the Act to try and define more clearly the area in which the central bank works? Would you think of giving the government power to direct the central bank on disagreements?

MR. MACAULAY: Well, for my part, to start it, Mr. Gibson, our view was that we could -- and I don't think we have actually worked out any phraseology; but I don't think it is beyond the possibility that we could make a run at it -- but our view was that there has been in the past some indefiniteness as to the relationship between the Bank and the Minister of Finance, and we think that perhaps this is not in the best interests of the stability of the financial community. To that extent we felt that it could be established either in the preamble of the Bank of Canada Act or in one of the substantive sections of the Act, that it is the responsibility of the Bank to report to and through the Minister of Finance, to the House of Commons or to the government -- or however it is phrased -- and whatever phraseology is necessary to make it quite clear that the Bank of Canada is an

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agent in more than just debt management of the government.

COMMISSIONER GIBSON: You are saying specifically that the Bank of Canada should be an agent of the government?

MR. MACAULAY: I don't know that "agent" -- pardon?

COMMISSIONER GIBSON: ... of the government: of course, it is a creature of parliament.

MR. MACAULAY: Yes.

COMMISSIONER GIBSON: At least, parliament set it up and can change it if it wants to. Are you saying the Bank of Canada should be part of the governmental set up, or should it have a certain degree of independence?

MR. MACAULAY: Well, what is a fellow who has independence but who has to report to somebody? I don't know what kind of independence he has. I think they should have a kind of independence, but the difficulty is in defining "independence". As a rule you end up with the fellow not having an awful lot of independence, or he is completely independent. I think what we are trying to strive for is that it should be perfectly clear when the federal government sets goals and objectives on a five or ten year basis that you balance international payments, to obtain a 4½ per cent rate of growth, et cetera, et cetera, and every other effort that is made by the government, monetary, fiscally, budgetwise, and so on, is bent in that direction. This means if you leave the Bank

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of Canada to pursue its own general policies you may be operating at cross purposes. I don't know the technical arrangement. What we were looking at was in terms of the net result rather than the aegis by which it would be accomplished.

COMMISSIONER GIBSON: There are so many varieties of this, you see.

MR. MACAULAY: Yes, there are.

COMMISSIONER GIBSON: One suggestion has sometimes been made that the Minister of Finance should have power to direct the central bank to do certain things, and this is simply a reserve power that would not be used unless a fundamental difference came up. You almost made me think when you started to talk about this that you thought perhaps the Bank of Canada could be part of the Department of Finance?

MR. MACAULAY: No, I don't think I would want to state that, but I would not be unprepared to say so if that was necessary to make sure it reflected government policy in relation to long range planning.

COMMISSIONER GIBSON: You say "in relation to long range planning"; you don't think it would be necessary in short run changes in government attitudes?

MR. MACAULAY: I am sorry, I missed that.

COMMISSIONER GIBSON: You say it should be to do with long range government policy?

MR. MACAULAY: Yes, sir.

COMMISSIONER GIBSON: What about day-to-day, week-to-week, month-to-month changes in government

of Canada to pursue its own general policies you may be operating at cross purposes. I don't know the technical arrangement. What we were looking at was in terms of the net result rather than the aegis by which it would be accomplished.

COMMISSIONER GIBSON: There are [illegible] varieties of this, you see.

MR. MACAULAY: Yes, there are.

COMMISSIONER GIBSON: [illegible] sometimes been made that the Minister of Finance should have power to direct the central bank to do certain things, and this is simply a reserve power that would not be used unless a fundamental difference came up. You almost made me think when you started to talk about this that you thought perhaps the Bank of Canada could be part of the Department of Finance?

MR. MACAULAY: No, I don't think I would want to state that, but I would not be unprepared to say so if that was necessary to make sure it reflected government policy in relation to long range planning.

COMMISSIONER GIBSON: You say "in relation to long range planning"; you don't think it would be necessary in short run changes in government attitudes?

MR. MACAULAY: I am sorry, I missed that.

COMMISSIONER GIBSON: You say it should be to do with long range government policy?

MR. MACAULAY: Yes, sir.

COMMISSIONER GIBSON: What about day-to-day, week-to-week, month-to-month changes in government

attitudes? Should the Bank of Canada be highly responsive to that, or should it to some extent be set off to the side to protect it?

MR. MACAULAY: We have said on page 6, paragraph 21:

"The relation between the Bank of Canada and the Government of Canada must be clarified also with respect to the policies used in pursuing the chosen goals. Monetary, budgetary and debt management policies are totally interrelated as to the techniques employed and their effects. In view of the economic, social and political implications of these policies, particularly with reference to economic growth and employment, it would be unwise to leave any doubt as to the ultimate responsibility of the Government of Canada in these matters."

I recall reading a statement of Mr. Rasminsky some time ago -- perhaps you could restate that, Mr. Stevenson?

MR. STEVENSON: I think Mr. Rasminsky's statement, when he became Governor of the Bank of Canada, was quite close to what we have been thinking.

COMMISSIONER GIBSON: To what you had in mind?

MR. STEVENSON: Yes, except this is not,

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MR. STEVENSON: Yes, except this is not,

of course, in the statute.

COMMISSIONER GIBSON: That makes it clear to us what you mean. Thank you very much. Those are all the questions I have, Mr. Chairman, in this section.

THE CHAIRMAN: Are there any further questions on this point?

COMMISSIONER HARROLD: In the second section of the brief, "The need for more research and information", I think in general it speaks pretty clearly of what areas and of what you have in mind, and I had thought of one or two questions, but in Mr. Macaulay's addition to the material which is here presented in this section he did suggest four broader areas that might be the subject for study by such an independent institute for economic research. I don't know that I have in mind any particular questions, but I probably would like to ask one question of Mr. Macaulay, and that is, that in the event this national institute of economic research had been set up some time ago and was operating at the present time, in your first suggestion of a broader issue which may be studied you suggested the impact of E.E.C. on trade. Would you think that a body of this kind at this stage of the development of E.E.C. would be able to supply information, or what kind of information or conclusions or forecasts, or what could they provide to business in Canada or government, or whoever it may be, at this stage of the development, that may be useful?

MR. MACAULAY: Mr. Harrold, the reason I suggested these four was that I knew if I didn't

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MR. MACAULAY: Mr. Harrold, the reason I suggested these four was that I knew if I didn't

suggest some you would ask me which four I might suggest. So, I picked them, and I knew the next thing you would ask me would be why I picked these four. And, that is a perfectly fair question. Once a question or problem has been delineated, it is a great deal easier to deal with it than if it has not been. I wonder whether in terms of exports we are thrashing around trying to pitch mist with a hay fork or whether, in fact, we are dealing adequately with this. We have made recommendations with reference to export credits; we have made recommendations with reference to tax incentives, and so forth. I don't know this is basically the area to answer our capacity to compete effectively in E.E.C. There are certain areas in E.E.C. that are quite apparent from the studies we have done in our Department in which our private industry in Canada is going to have a magnificent opportunity to take part. It seems to us, then, if those are the areas, we should try to frame, if we can, certain government policies to assist us not just to compete but to lead the group. Some of them relate to primary products, but some relate to manufactured products. This is one area.

I think if documentation, insurance, and these things are going to become a greater or a lesser problem, that perhaps it ill behooves the government or somebody not to be aware of these and to be making plans now. I think when the conditions of E.E.C. jell and cement together it may be too late for us to get into some of these fields. In short, this may

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not be one of the things that a national institute should study.

I was simply suggesting it as one. Conditions change because they are still negotiating the agricultural conditions of Britain's entry into E.E.C. Therefore, it is very difficult to formulate a long-range policy on a condition that is changing; a base that is sliding around. Nevertheless, from the studies that we have carried on in the Department of Economics and Development, in our province, there are certain opportunities; certain things that we know we can do to help industries in our province which, if we had not carried out, we do not think we would be aware of. I wonder whether these things should not also be known at the Federal level because, after all, the Federal Government has trade offices all over the place. It has just apparently gone into export credits by lending directly to foreign governments. There are many things that it maybe could or should get into which would be open to it if they knew what the impact was going to be on the Canadian economy. I perhaps have skated around this without coming directly to your question, but I think that is the best I can do with it.

COMMISSIONER HARROLD: There are some studies being made, of course, by -- I am not too sure of the exact name for it -- the Canadian-American trade committee. It has put out a pretty good study -- I am informed it is the Canadian Trade Committee -- on this sort of thing. You feel that a study of this kind should go further than that in this regard?

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MR. MACAULAY: As I said, sir, I do not want

to tie my hat on this particular study. I just thought I might suggest it as a possibility. It might be rejected upon the establishment of such an institution. Maybe there are others which are more important, or more practicable or practical, but this is an important subject and I do not think really everybody looks at the European Economic Community as something quite magnificent, and somehow stand back in awe of it. There seems to me that there are opportunities in it as well as risks, and I think it is incumbent upon our industries in Canada to know more about it.

COMMISSIONER HARROLD: Mr. Chairman, I believe that is all I have on this particular section, but in view of the fact that this was assigned to me I might ask one question at this stage as far as the whole brief or representation is concerned, and perhaps from the point of view of what is most interesting to my mind, and that is that you have already said that your primary interest as far as your brief is concerned is in respect of secondary industry, that is related to financing and banking. Your brief clearly shows that this is your main concern. Am I to gather from this that as far as the provincial government is concerned in the field of financing, that you have not the same concern for primary industry and, shall we say, agriculture in particular, as having any problems in the field of financing at all and banking?

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COMMISSIONER HAROLD: Excuse me. Do some

of the broader headings in your opinion cover that?

MR. MACAULAY: I think so. I think perhaps we have this under the heading of small businesses, for example. I would not want it to be thought that our brief is directed toward secondary industry only. All I was saying in reply to Mr. Gibson's question was we recognize that this is a most important area in relation to handling our employment problem, but it does not necessarily handle some of the other social capital problems or investment problems.

In terms of agriculture, there are a number of problems and I suppose always will be; the number of people that are leaving the farm, for example. This is a characteristic of an advancing and more sophisticated society. As they leave the farm, they also leave the factories and enter more into service industries. This is a characteristic of the type of economy that we have. We think there are problems in this respect but we have not specifically dealt with them here.

As the Premier originally pointed out, we are interested from the point of view of selling agricultural products. This is an export problem. Food processing we treat as a secondary industry even though it is agriculturally based. These things we really intended to include in a general way, sir.

COMMISSIONER MACKINTOSH: May I ask in respect of this area, do you think specifically in terms of a private non-profit organization such as the

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COMMISSIONER MACKINTOSH: May I ask in respect of this area, do you think specifically in terms of a private non-profit organization such as the

National Bureau is, or a co-operative government organization?

MR. MACAULAY: Frankly I think we thought in terms of something on a private basis. We think it is in the basic interest of industry in the private sector, and we rather hoped that we could encourage the establishment of something of this nature apart from government but with, of course, government co-operation. I do not know that we had in mind government support. When I was talking about that originally, was that the concept?

I think on pages 7 and 8, sir, we discuss this and we say that in our province we are most happy to co-operate with such an organization and, in fact, we would be happy to help create it if we could, but I think its basic strength would be more lasting if it were an enterprise of the private sector of the economy on a non-profit basis.

COMMISSIONER MACKINTOSH: My recollection is that the National Bureau in New York does not undertake much of the kind of study you have given as examples.

MR. MACAULAY: Well, that may be.

COMMISSIONER MACKINTOSH: That is in areas which underline policy issues immediately. Most of their studies have been much more fundamental and long-range.

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could lead to industrial enlightenment, if I may say that.

Our interest has been limited to what experience we do have in Ontario in relation to trade matters and encouraging secondary industry to compete in the outer markets and to sort of rise up and strike a blow on their own behalf. We have felt that we suffer from an inferiority complex as a nation, province or as our industries do and, secondly, there is a lack of knowledge of opportunities available and the problems that they face. We emphasize this particularly in respect of small business, but we think it is also typical of some of the large businesses -- not those that can have people in foreign markets constantly and afford to have them there, but we feel that --"ignorance" is a very harsh and I do not like to use it in this sense -- lack of information is a debilitating factor in developing the economy. These kind of studies might be very useful quite apart from government policy which might flow from them.

PROFESSOR TRIANTIS: The reason why we mention the National Bureau is to emphasize that it is a private non-profit organization, independent of national prestige.

Now, we also refer to the Bureau as existing, for instance, in Germany, and we think it undertook studies of a thorough nature, or of India, which we set up -- that is "we" in the West; their National Economic and Development Council, which

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In the States the National Bureau is able to specialize in studies, as you mentioned, sir, which are not quite as close to policy-making, and the reason is that there are other institutes or committees that do that job. There is, for instance, the Committee for Economic Development. Maybe that will be the next stage, but we have to start with an institute and eventually get the second one that will do something closer to policy.

COMMISSIONER MACKINTOSH: I just wanted to get clear what you had in mind.

Next you mention the National Planning Association of the United States, and it does a good many studies of the sort that you have been mentioning. There is, of course, no reason why in Canada we should duplicate the pattern of any other country, but rather adapt it to our own particular purposes.

MR. MACAULAY: In fact, doctor, there has been a tendency to sort of look at our economy as a small junior addition of the American economy. I do not think that this is true. Therefore, what kind of palliatives or medicines have helped the American economy may not necessarily affect us in the same way.

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examples of study that I put in were inserted by me without any knowledge of my confreres, so the fact that we have all been able to still stick together with it I think is very fortunate.

COMMISSIONER MACKINTOSH: Well, as a former civil servant I would always judge that to be a mistake.

THE CHAIRMAN: May we proceed to the next subject, Mr. Leman?

COMMISSIONER LEMAN: Yes, Mr. Chairman. I have a few questions to ask in respect of part III of the government's brief where it says in part that you are really getting into a field that is of primary interest to the Commission, besides being of interest to the provinces and the municipalities.

To start the discussion, would you give us a broad statement of the approach to financing that the province and municipalities have or should have, and I have in mind the relation of the total needs that should be financed through borrowing and the part that should be financed through tax revenues in an ideal situation. You talk through this part about investment in human capital, but when you come to decide what you want to finance through borrowings and what you should finance through current taxes you are not using capital in that sense there, are you, or would you go back to more physical measurements of what should be financed through long-term borrowing?

MR. MACAULAY: I think, sir, if I might at least initially, ask that this question be directed

to the Premier and the Treasurer. I have my own views on this which I will give following up after they have spoken, but this is their basic field and I think perhaps your question should be directed to them at this moment.

PREMIER ROBARTS: Well, as I gather your question, it is, what proportion of the expenditure in certain fields, municipally and provincially, should be met from current account and should be met by borrowing?

COMMISSIONER LEMAN: Yes, what principles should be followed by the provinces and by the municipalities?

PREMIER ROBARTS: Well, subject to any comment the Treasurer may have, I would say that in our municipalities this, in many instances, gets down to the question of what you can do. In other words, you do not necessarily follow a formula. You end up with what you can do within the area of practice and what your requirements are, and a formula would not be applicable to different municipalities. Although we do work in this province to certain formulas which are established by an organization called the Municipal Board which functions under the Department of Municipal Affairs, and it sets a limit on debt in relation to assessment. This might drive a municipality into financing out of current account something that perhaps should be financed by debt because they may have reached the debt limit that the Municipal Board will permit them to issue in

debentures.

Then to further complicate the situation you will run into situations where there are statutory requirements that the municipality must meet regardless of what the Municipal Board may say, or what formula they may set up as being the proper formula to keep the municipality financially sound. I am falling into Mr. Macaulay's trap; I am making a speech. We end up in this position; it is very difficult to devise a formula to meet the requirements that you are talking about.

Discussion in regard to the point that we were speaking of here will be my answer when I am questioned further.

COMMISSIONER LEMAN: Let me illustrate a little bit what I have in mind. In paragraph 41 at page 13 of your brief you have given some indication of the magnitude of your problems in the realm of education for the next 10 years and some indication of the magnitude of your problems in the realm of health, but you start the paragraph by saying:

> "We can illustrate this point by a brief reference to the Ontario situation."

You end up by saying:

> "These figures give some indication of the expanding total financial burden facing the Province in the coming years."

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You end up by saying:

"These figures give some indication of the corresponding total financial burden facing the Province in the coming years."

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in the tax yield that the province should be entitled to expect, and the part of the total burden that is likely to have to be financed in the capital market. Those are the kinds of things that would give us a real indication of the magnitude of the problem from the point of view of financing in the capital market.

PREMIER ROBARTS: This will lead us into another part of the brief really because it is very difficult for us to estimate what portion of our expenditure we will have to meet in the capital market by borrowing, until we know what our revenues are. As is pointed out in the brief, it is very difficult for us to forecast our revenues, although we can forecast pretty accurately some of our expenditures. At least, we can forecast what our expenditures will be if we are to achieve 100 per cent of what we want. We may have to settle for something less than 100 per cent in the future. We know, for instance, that the children are going to be there. In the field of expenditures anticipated we will say at the university level we can forecast from our elementary school population how many will be in secondary schools, and statistically it is not difficult to forecast the number that will be knocking at the doors of our universities, but we cannot forecast whether we will be in a financial position to provide the facilities that these young people will need even though they are there. That is what I meant by saying we can forecast 100 per cent

of what we would like to do from a financing point of view. We may be forced to settle for less than perfection, if you understand what I mean, and simply not provide the facilities we would like. It may be that the Treasurer or Mr. Brown, the Deputy, can give you what you are seeking, and I believe that is a forecast in respect of what our revenues will be compared to what our expenditures will be.

COMMISSIONER LEMAN: Well, I would not go quite so far as to ask for actual figures for a projection of ten years right at this meeting, but I am asking you whether there is a definite financial policy.

MR. ALLAN: I might indicate that there is a financial policy at the provincial level. It has been the policy and the practice of the government, even since the time that your Chairman was treasurer, to finance all current expenses from current revenue, and to endeavour to finance a greater percentage of the capital costs which comes to a government in providing some of these items which are mentioned here by borrowing. The percentage that is borrowed varies from year to year; but we have been able, and hope to continue to be able, ~~to~~ pay a substantial percentage of the cost of the capital programme from current revenue, and to provide as well a sinking fund that will retire the debt in a period of 40 years. That is our policy.

MR. BROWN: It is 30 years.

MR. ALLAN: Yes, 30 years. That has been generally the policy of the government. Mr. Hickey is here, and he is very familiar with the controls of the Municipal Act as they affect municipal financing. The same practice is carried on there, except that most capital expenditures are financed by borrowing by the municipalities. There is control, as has been pointed out by the Premier, but there is likewise a very strict control with respect to the financing of any current expenditures by debt or by debentures or bonds on the part of the municipalities. Mr.Hickey could give you any particular instance you would like in that connection. I do not know whether that answers your question.

MR. ALLAN: I might indicate that there is financial policy at the provincial level. It has been the policy and the practice of the government, even since the time that your Chairman was treasurer, to finance all current expenses from current revenue, and to endeavour to finance a greater percentage of the capital costs which comes to a government in providing some of these items which are mentioned here by borrowing. The percentage that is borrowed varies from year to year; but we have been able, and hope to continue to be able, to pay a substantial percentage of the cost of the capital programme from current revenue, and to provide as well a sinking fund that will retire the debt in a period of 40 years. That is our policy.

MR. BROWN: It is 30 years.

MR. ALLAN: Yes, 30 years. That has been generally the policy of the government. Mr. Hickey is here, and he is very familiar with the controls of the Municipal Act as they affect municipal financing. The same practice is carried on there, except that most capital expenditures are financed by borrowing by the municipalities. There is control, as has been pointed out by the Premier, but there is likewise a very strict control with respect to the financing of any current expenditures by debt or by debentures or bonds on the part of the municipalities. Mr.Hickey could give you any particular instance you would like in that connection. I do not know whether that answers your question.

COMMISSIONER LEMAN: Well, we will keep on digging a little in this realm. In paragraph 43 you explain to us that between the years 1949 and 1961 the total budgetary expenditure of the government of Ontario rose quite a bit more in percentage than did that of the federal government, or even the gross national expenditure. Now, if that has happened since 1949, what evidence is there in that period that the capital market and/or the tax sources available to the provinces or the municipalities have failed to provide adequately for their needs? Is there such evidence?

MR. ALLAN: Of course, this matter has been discussed many times at Federal-Provincial conferences. The provinces generally, certainly our province in particular, have pointed out the fact that is made in this particular paragraph. That is, that what we may call capital investment in our human resources has grown. One of the problems of financing the province is as a result of that particular facet having grown more quickly than has the overall economy, or -- this is not, of course, our particular problem -- with respect to the federal government. That is the reason we have had to impose additional taxes during the last year roughly, in order to meet these situations.

COMMISSIONER LEMAN: Would you think that in the period you are talking about, 1949 to 1962 approximately, which is some 13 years, because of this rate of growth in budgetary expenditures, there has been a need for too much borrowing of the total need

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COMMISSIONER LEMAN: Would you think that in the period you are talking about, 1949 to 1962 approximately, which is some 13 years, because of this rate of growth in budgetary expenditures, there has been a need for too much borrowing of the total need

as against the amount raised on current taxes, or not?

MR. ALLAN: No, we do not think that. There may be a question whether anything is too much or whether it is desirable, but we do not feel that the extent of our borrowing has in any way harmed our financial position as a province.

There arises at the same time the question whether one wishes to increase one's net debt from year to year, thereby increasing the cost of interest payment; but I might say that it was for the purpose of keeping ourselves in an excellent financial position that we did impose additional taxes, which is not anything that any government may choose to do because they think it will be popular. However, we have done it and we are keeping ourselves in that position, and presently we are in a sound financial position.

COMMISSIONER LEMAN: Therefore you feel that during the period in question your needs have been fairly well met through a mix of tax policy and borrowing policy?

MR. ALLAN: That is so.

COMMISSIONER LEMAN: Yet for some reason you fear that in the future you cannot meet these with the proper mix?

MR. ALLAN: Well, we wonder how far we can go in increasing revenue. We can see, as the Premier has pointed out, the increase in the cost of these services, particularly the social services, and it does give us cause to be concerned.

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PREMIER ROBARTS: One we foresee so clearly, and the other we look at through a glass darkly. In other words, our expenditures seem to be pretty well fixed, and we have forecast a great many of them. But our income we do not see clearly; nor do we see it necessarily expanding as rapidly as our expenditure requirements. I think the history of the past few years bears this out.

COMMISSIONER LEMAN: I am trying to get at what is your basic worry about the future. Is it that if you are not given more leeway or better sources of tax revenues you will then be forced to meet too much of the province's needs through borrowing? Is that the focus of your worry?

PREMIER ROBARTS: We must find new sources of taxation.

MR. ALLAN: At the same time, I think we note the feeling generally that there is a limit to the burden of taxation that an economy wishes to carry if it is going to be in a position to be a serious competitor in world markets.

MR. MACAULAY: I think that one of our opening points which we are making is the last sentence on page 16, that:

> "It is obvious that a short-period decline in the rate of growth of total financial resources of these governments might require very drastic -- well-nigh impossible -- restrictions in their other expenditures if these

PREMIER ROBARTS: [illegible]

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MR. [illegible]: [illegible] opening points which we are making is the last sentence on page 16, that:

"It is obvious that a short-period decline in the rate of growth of total financial resources of these governments might require very drastic -- well-nigh impossible -- restrictions in their other expenditures if these

" governments are to provide steadily growing outlays in social and human capital."

The impression I had as a partial author of this section was that we were directing the burden of our comments to the necessity of programmes at a national level which would bring about growth, from which we could obtain the tax levels. We were pointing out what we would need, and we were pointing out, in addition to that, that when the government applies the brake they have to remember where they are. That is the point we want them to know, because I do not think we have the flexibility in our budgeting that they have, and when they decide on tight money, it is because they have greater flexibility in their financial, fiscal, monetary, budgetary policies, et cetera, that we do not possess that they do not get squeezed like we get squeezed. That is the burden of this argument, although we may not have expressed it as well as you would like to.

We are not complaining about where we are going to get the money. All we are trying to make is an effective argument that we must have some assurance of the economics and the borrowing capacities -- what you referred to as the "mix", sir. We are not complaining that it will not be possible, but we are warning that it will not be possible unless we have national policies directed towards a satisfactory rate of growth.

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Secondly, we want to point out that although the policies the federal government does apply in momentsof duress, and whatever else may apply, on a national basis, we do not think sufficient consideration has been given to the problem of the provinces and the municipalities in relation to their fixed necessities, their fixed outlay.

COMMISSIONER LEMAN: Mr. Macaulay, earlier in the discussion you talked about this Commission trying to ferret out who were the bad boys and who were the good boys when we are thinking in terms of inflation, and I imagine that when you were talking about the "bad boys" you had in mind what is called the demand pull inflation type of situation. A lot of representatives of municipalities, not only from Ontario but from elsewhere, have explained to us that they feel they could bring a great contribution towards greater economic activity through municipal work of one kind or another if they are encouraged and helped to do so. Would that not point to the fact that they could be bad boys? We are, of course, using "bad boys" in a nice sense here. In other words, what surprises me a little bit is the danger of this concept, when we are thinking of an inflationary situation, that some are bad boys and others are not, whatever they do, whatever is their rate of growth, or whatever are their total expenditures.

MR. MACAULAY: I do not think, with great respect, that it is what the total expenditures are

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MR. MACAULAY: I do not think, with great respect, that it is what the total expenditures are

nearly as much as when they do it that matters. This was really what we had in mind. I would think that inflationary problems are basically caused by people who put on the pressure at the wrong time, and who, by the very nature of their occupation, may do so. Whether this is true of the municipalities or not, I am not prepared to say, but I would not have said so.

COMMISSIONER LEMAN: Is it your basic tenet here that the nation as such should, on a long-term basis, focus its attention on the needs in the realm of the provincial goals and activities -- this investment in human capital about which you are talking, improvement of our municipal facilities, et cetera -- that this should remain stable and everything else should fluctuate around it to accommodate that? Is that it?

MR. MACAULAY: No, sir, with respect, I think that is not so, but again, this situation is not so today. What we want to have is an awareness at the federal level and the Bank that when policies are applied --
It is like being in the army. Everybody got an aspirin; no matter what you had, you got an aspirin. This is the way we have been applying economic policies, it seems to me, and I think that today is a new day and a new era, and that although an aspirin may be an awfully good thing for a headache in Ottawa, it is not doing much to help the municipality of Etobicoke. That is my point.

I think we have to have selective credit controls. We have to have flexible national policy in relation to these things, and all we are trying to do is to hope that you will draw to the government's attention that you cannot just apply blanket measures in view of the fact that the municipalities and the provinces have these very heavily built-in expanding, fixed expenditures. Is that not really the basic problem?

MR. ALLAN: Mr. Leman, I might point out that the province does make a great deal of money available to the municipalities, so that the problems of the municipalities are shared by the provincial government. In fact, 45 per cent of our revenue roughly is paid to municipalities in the form of subsidies and grants of one type or another.

COMMISSIONER LEMAN: Yes. But I am still a little puzzled by the fact that both the municipalities and yourselves -- and here I refer to paragraph 53 -- claim that you could collaborate with the federal authorities in anti-cyclical policies.

MR. MACAULAY: I do not think that this is what we intend. We recommend that machinery be devised for regular consultation. So that when they are planning various policies which you might describe as anti-cyclical, we can draw to their attention the effect that this is going to have on the municipalities and the provinces themselves. The way you phrased it, Mr. Leman, it sounded as if we in concert should concoct a policy. That is not

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the point. They have responsibility for the policy. All we want to be able to do is to have our day in court.

COMMISSIONER LEMAN: Do you not think that in fact the municipalities and the provinces could collaborate with the federal authorities in implementing anti-cyclical policies?

MR. MACAULAY: Yes, I think this is quite possible.

COMMISSIONER LEMAN: Does that by itself infer a certain amount of fluctuation in the level of expenditures?

MR. MACAULAY: I would think so. But only to the extent that it does not negate a point we have already made, namely that we cannot avoid a very large portion of the expenditures that we are already committed to make.

COMMISSIONER MACKINTOSH: All at stake here is some margin. Periods of tight money have recently been fairly short. It is not a matter of good and bad boys but of too many boys trying to get through a bottle neck at once. There may be a certain percentage of the margin, maybe only a period of six months, which will cover the period. We have a tremendous number of clients who all claim that they ought to be freed from any penalty of high interest rates; it is only somebody else who needs to be restrained. In fact, are you particularly restrained in your capital expenditures if interest rates for a period are relatively high?

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PREMIER ROBARTS: It depends on the length of the period, Dr. Mackintosh, and with certain expenditures at the municipal level it might be very difficult to postpone them.

THE CHAIRMAN: Yes, but many of them could be postponed.

PREMIER ROBARTS: Yes. And I would accept Mr. Leman's point, that some anti-cyclical planning could be accomplished in concert, as long as your periods are not too great.

THE CHAIRMAN: All the municipal expenditures do not go in schooling.

PREMIER ROBARTS: That is quite right.

THE CHAIRMAN: And human capital of that kind. Many of them go into other matters which were once considered to be within the realm of the province, but which are now regarded as something you are entitled to.

MR. ALLAN: Of course, in times of tight money, which there might be, certainly before the effect of the tight money has disappeared, it may be a time when it is desirable to accelerate the economy.

THE CHAIRMAN: Well, there would not be tight money.

MR. ALLAN: Well, that was so. We have gone through that.

THE CHAIRMAN: Of course, there have been mistakes made from time to time on all sides.

MR. ALLAN: Of course, the high interest

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THE CHAIRMAN. Of course, there have been [illegible]

MR. ALLAN: Of course, the high interest

rate is a deterrent in doing something that is probably very sound, in going ahead with public works of one kind or another.

THE CHAIRMAN: You have also to remember this, that for very many years the provinces and everybody else were borrowing at a very low interest rate. If you look at your whole debt structure, the net position is not as bad as that.

MR. ALLAN: Your Lordship, you were the only one who could do that!

I am afraid when you think of some of the interest rates you paid that your face must really ---

MR. MACAULAY: Break out in a smile. On page 16 we note -- whether it is helpful to the argument or not -- that 56 per cent of the current expenditure of all provincial governments and 40 per cent of municipal current expenditure consisted of outlays on education, health and public welfare. Now, I don't know whether that helps Mr. Leman's point. I do think that the point he makes is worthwhile and that there is room for co-operation, but you have to have the mechanics to bring this about, Mr. Leman, and I think this is one of the points which we were attempting to make in the paragraph referred to as paragraph 53.

We would like an opportunity of expressing our views. These problems are under consideration, and I think you quite rightly point out that it may be by understanding each other's problems that we can perhaps shorten the period of tight money, but fundamentally the burden of our argument here I think is set out in paragraph 55 -- although it is hard to isolate one paragraph -- where we say:

> "This is not the place to consider in any detail the merits and disadvantages of our system and techniques of credit control, or the pros and cons of selective control of credit. There is hardly any type of monetary policy that does not, in effect,

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> "This is not the place to consider in any detail the merits and disadvantages of our system and techniques of credit control, or the pros and cons of selective control of credit. There is hardly any type of monetary policy that does not, in effect,

discriminate against some sector of the economy. It is necessary, however, to convey our view that tightening of credit, in the manner practised in Canada, has often had an unduly limited effect on those sectors of the economy, investment in inventories, purchases of consumer durables or land speculation etc., which might have been responsible for inflationary pressures. Changes in interest rates, may not affect decisions in these areas because interest costs respond too slowly to changes in open market rates of interest, changes in interest rates are a secondary consideration in decisions to borrow, or, because informal rationing of credit may not have been very effective. On the other hand, credit tightening has affected seriously sectors of the economy which were not among those responsible for sudden inflationary pressures, such as government expenditure programmes which are vitally important from the point of view of the desirable rate and pattern of the economic and social development of Canada. For the reasons indicated in the previous paragraph provincial and municipal governments have been hit hard by policies of credit restriction; so has small business, as indicated in more detail later in our submission."

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COMMISSIONER LEMAN: Well, in that paragraph, sir, I point out that you use the words:

> "has affected seriously sectors of the economy which were not among those responsible for sudden inflationary pressures, such as government expenditure programmes..."

and a little later on you use the words:

> "provincial and municipal governments have been hit hard by policies of credit restriction..."

Does the record give some evidence that this is so?

MR. MACAULAY: Well, if you mean can we borrow money anywhere and at any old rate at all, no. However, we provincially have been able to borrow; I can't say the same for the municipalities. For example, this city itself, Ottawa, went recently to New York to borrow. Quebec Hydro went to New York to borrow, and a number of people have gone to New York to borrow to get a lower interest rate. If you are talking about can we borrow at all -- no, I would say that the province has not been stopped in the path of development by the fact that it hasn't been able to borrow, but it has had to borrow at higher interest rates, certainly, than it would otherwise have had to borrow at if consideration had been given to the problems of the province and the municipalities when tight money policies were being applied, but I think that is about all I can say on it.

COMMISSIONER LEMAN: Well, in that paragraph, sir, I point out that you use the words:

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I think quite rightly, perhaps, the semantical emphasis which we placed on certain words hit hard, and we should perhaps have qualified them and placed them in another way, but I might say this to you, sir, that there were seven drafts of this, and I don't think that we would have gotten it out if we had had to exercise the delicate weight of words that might have been required.

COMMISSIONER LEMAN: No, no; what I am leading at is this; what do you call being hit hard? Going to New York to borrow money is not necessarily being hit hard.

MR. MACAULAY: We think paying 6½ per cent, or something of that order, as being hit hard when you have a billion dollar debt, as we have, and with the prospects of adding greatly to it in the next three or four years. What are we up to, what is the interest to us?

MR. ALLAN: About $80 million.

MR. MACAULAY: About $80 million.

THE CHAIRMAN: What is it in per cent?

MR. MACAULAY: What percentage?

THE CHAIRMAN: Yes?

MR. MACAULAY: Oh, 5.65, perhaps.

THE CHAIRMAN: Well, is 5.65 such an exhorbitant rate?

MR. MACAULAY: It is when you have been getting it at 3½.

THE CHAIRMAN: It is evening up a little bit.

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MR. ALLAN: About $50 million.

MR. MACAULAY: About $80 million.

THE CHAIRMAN: What is it in per cent?

MR. MACAULAY: What percentage?

THE CHAIRMAN: Yes?

MR. MACAULAY: [illegible]

THE CHAIRMAN: Well, is 5.65 such an exorbitant rate?

MR. MACAULAY: It is when you have been getting it at 3½.

THE CHAIRMAN: It is evening up a little

MR. ALLAN: Everyone has a standard, whether it is moral or spiritual, whatever it is, and it always seems to me that when we get above 5½ per cent the interest rate is high.

THE CHAIRMAN: We have had many years of easy times on borrowing money, and it has been suggested to us by one expert witness that if they had begun to tighten up money a little bit earlier than they did that any crisis situation might have been avoided.

MR. MACAULALY: Well, of course, we find that ---

THE CHAIRMAN: But you have to assume in these matters that when the parties do take certain steps that they believe are in the best interests of the country at the time, and when it is all over and you look back on it you see other factors that were not apparent at the time,and from hindsight you may decide, perhaps, that you were mistaken.

MR. ALLAN: I think if I might appraise the situation, the reason for mentioning it is this; that very probably a province will require more money during a period of tight money than they do when the economy is good, that is, when everything is flowing along nicely, and we noticed the fact and we did have to pay 6 per cent for bonds, and if that continues for 20 years you don't like paying 6 per cent.

MR. MACAULAY: I wouldn't want Your Lordship to misunderstand; we are not trying to substitute our opinion for the Federal Government as to when

whether it is moral or spiritual, whatever it is, and it always seems to me that when we get above 5½ per cent the interest rate is high.

THE CHAIRMAN: We have had many years of easy times on borrowing money, and it has been suggested to us by one expert witness that if they had begun to tighten up money a little bit earlier than they did that any crisis situation might have been avoided.

MR. MACAULAY: Well, of course, we find that ---

THE CHAIRMAN: But you have to assume in these matters that when the parties do take certain steps that they believe are in the best interests of the country at the time, and when it is all over and you look back on it you see other factors that were not apparent at the time, and from hindsight you may decide, perhaps, that you were mistaken.

MR. ALLAN: I think if I might appraise the situation, the reason for mentioning it is this; that very probably a province will require more money during a period of tight money than they do when the economy is good, that is, when everything is flowing along nicely, and we noticed the fact, and we did have to pay 6 per cent for bonds, and if that continues for 20 years you don't like paying 6 per cent.

MR. MACAULAY: I wouldn't want Your Lordship to misunderstand; we are not trying to substitute our opinion for the Federal Government as to when

there should be and when there should not be tight money, all we are saying is this, when the government decides to adopt a policy, we think it unwise to just throw a blanket over the whole country from coast to coast. We think that there is room today for selective control.

THE CHAIRMAN: But what do you suggest as effective selective control?

MR. MACAULAY: Oh well now, our basic burden here was to point out to you that we think that this is one of the great charges and opportunities that you gentlemen have before you.

THE CHAIRMAN: Yes, I know, but from the studies you have made of this whole problem I would have thought you would have had a concrete recommendation. What sort of a selective control would you be prepared to submit should happen? Selective controls might affect you as well as somebody else.

MR. MACAULAY: Well, I will tell you -- to change the subject, that is always a good idea when you get cornered -- that one area in which I think it is absolutely fundamental that we have got to have a selective control is in terms of export credit. I don't think in other circumstances that would apply, but I think we will have to establish, perhaps nationally, a special fund, perhaps special arrangements with the banks or with private industry, or whatever it may be, but I don't think we can put on a blanket credit control relating to export credit.

THE CHAIRMAN: How does that help the municipality?

MR. MACAULAY: Sir, I was changing the subject.

THE CHAIRMAN: I think that you have a section on export trade.

MR. MACAULAY: Yes. You were going to come to it. Do you mean you want me to get back?

COMMISSIONER LEMAN: Mr. Macaulay, I don't want to argue with you, I am just asking some questions, but let us not change the subject for another moment, if you don't mind. My point is this; it seems to me, without getting into the techniques of selective controls or exactly what form they should take, your point is that by reference again to paragraph 55 that monetary policy at the time of high demand when you want to be restrictive should hit just those sectors which you have mentioned in the middle of paragraph 55 on page 18; investment in inventories, purchases of consumer durables and land speculation. This is the sort of thing which you feel should take the brunt of restrictive monetary policy?

MR. MACAULAY: I think the point, sir, is they have no built-in need, theirs is postponable but, as the Prime Minister has indicated, once we take children into the educational system you can't send them home with a note to the mother saying,"Send him back when tight money is over."

COMMISSIONER LEMAN: That is right, but I

think Dr. Mackintosh mentioned something a few minutes ago that should bring this thing into focus. When you try to effect, through monetary policy, the total level of expenditures in the country, you are trying to work on the fringe. You are not trying to destroy the whole system, you are not trying to stop education of children, that sort of thing, you are trying to stop the fringe. Are not the provinces and the municipalities partly involved in the fringe, too? They build.

MR. MACAULAY: Oh yes, they do build, certainly, but again all I can do is repeat our point, and that is that some areas of the economy respond quickly, either up or down, to tight money policies. Some respond very slowly and to some tight money doesn't matter a hoot and they will go ahead and back the market so long as they can get it, and we believe they can get it, and they will go ahead and spend it.

COMMISSIONER LEMAN: So it is with the province; it doesn't like the fact it costs more, but it goes right ahead anyway and that is what these other people do also?

MR. MACAULAY: And what we are trying to do is put a little emphasis on the purposes, if you want, the moral purposes for which the borrowings are taking place.

COMMISSIONER LEMAN: That is your point. I just wanted to get your point clearly on the record.

May I shift now a bit to this question of the sources of revenue that you deal with quite a

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COMMISSIONER LEMAN: That is your point. I just wanted to get your point clearly on the record.

May I shift now a bit to this question of the sources of revenue that you deal with

bit. There are some points which you make that puzzled me a bit, and I refer now to paragraph 44 where you suggest that the pressure that you refer to here may have led to over-expansion of certain taxes while others are under-utilized. Could you be more specific there as to what you had in mind in these two types of---

MR. MACAULAY: You mean as to which taxes may have been over-utilized and which taxes may not have been?

MR. LEMAN: Yes?

MR. MACAULAY: Well, speaking for myself, and I think the Treasury and the Premier -- and others have something also to say on this subject -- my own view is that the corporation tax has been over-utilized and I think, frankly, it has become a burden and the general movement around the world today is for a lessening of the corporation tax in the hope that having done so we can stimulate the economy and in the long run increase tax returns.

Examples of the under-utilization of a tax, what under-utilization of this may well be said to be -- although I don't necessarily join the ranks of those who would say it -- in Ontario it might be the sales tax. We had no sales tax until last year.

COMMISSIONER LEMAN: It has been under-utilized or not utilized at all?

MR. MACAULAY: Yes, and, Mr. Leman, it is a lower tax than, of course, there is in British

Columbia and I think in Quebec and in most of the provinces; in Saskatchewan it is 5 per cent, it is 5 per cent in British Columbia and 5 per cent in Quebec -- it is 6, is it, excuse me. Have you any other areas? It may also be that the real property tax, which in the next paragraph we point out has increased more than three times, and it would have had to have increased even more, but we are saying here that it would have had to increase more than three times if it had not been for the fact that the Province of Ontario, for example, has upped its aid to the municipalities by about $425 million, and this is a very large amount of money to be dealing in and if there had been a proper weighing of these things perhaps the realty tax may have gone up even more than it has. Now, I don't know that I can give you a definitive list; my staff may be able to help you or may be able to say something on that.

THE CHAIRMAN: We will have this answered and then we will adjourn.

PROFESSOR TRIANTIS: If I may come into the picture. Although it has been dealt with, there are two problems, one of a long-term and one of a short-term, and the long-term problem is this; we know what affects us, that provincial expenditures have risen faster than federal expenditures, and we anticipate that this will happen in the future. We have no evidence that the revenue from provincial taxes will rise faster than the revenue from federal

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taxes. This has not happened in the past and, as Mr. Allan suggested, the government had to impose a different tax altogether. We have no evidence and no assurance that this will happen in the future. It is the case of the provinces having to have enough revenue to meet the faster rise in expenditures. That is on the revenue side, to meet the expenditures, and on the revenue side we are concerned about the nature of taxation in Canada. Taxes don't only provide revenues, they have to do with incentives, economic growth, with welfare, with the distribution of the economy, and so on and so forth, so we feel it is not the case of where as soon as your expenditure needs a rise, you just raise the taxes that belong to you; we feel there is need for more general re-examination. What kind of taxes should rise?

For instance, an increase in the municipal revenue taxes from real property, is that desirable from the point of view of ecoonomic growth? Is that the kind of tax that has to be over-taxed, as it were? That is the question.

So that on the expenditure side, we think we should meet expenditures and we think we are getting the best structure or we think we are stretching to meet certain needs because these things are the responsibility of the federal and provincial governments.

MR. MACAULAY: To put it in a slightly different way, we wonder whether taxation in Canada

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hasn't reached the stage where taxation should be imposed with an eye on growth and the effect it will have on the economy rather than for the convenience of the tax collector.

THE CHAIRMAN: Well, we will continue this discussion at 2 o'clock.

MR. MACAULAY: It is still in the realm of discussion, isn't it? We don't want to give the impression we are having a fight; it is a discussion.

COMMISSIONER BROWN: We don't fight with anybody. It is conversation.

--- Luncheon adjournment.

--- Upon resuming at 2.05 p.m.

THE CHAIRMAN: Do you wish to commence now, Mr. Macaulay?

MR. MACAULAY: Yes, Mr. Chairman, I think we might begin, but before we do may I be permitted to make an observation. We have made some fifteen suggestions or recommendations to the Commission. I think those that affect the Prime Minister and the Treasurer most intimately are those upon which you are now proceeding, Mr. Leman. At a later stage of the afternoon it may be, because of some other arrangements, that the Prime Minister and the Treasurer will be leaving to catch a plane. I am anxious that the Chairman understands that the balance of this brief really affects the economists of our Department more than the Treasurer and the Prime Minister, and we will be staying over in Ottawa until tomorrow.

If it suits the convenience of the Commission we are very anxious to proceed this afternoon and continue for as long as the Commission feels it would like to continue, but I will ask the Commission to excuse the absence of the Premier and the Treasurer after 3.40 P.M. We would like to continue for as long as whatever we have to say is of use to the Commission.

THE CHAIRMAN: Very well.

COMMISSIONER LEMAN: Mr. Macaulay, despite the fact, as you say, some of the questions I have in mind asking should be addressed to the Premier and

the Treasurer, I would point out that this Commission is not the Royal Commission on Taxation, and neither are we consultants to the Dominion-Provincial Conference. Having regard to that I do not think we should ask you too much about reallocation of tax powers. I am talking about taxes in so far as they relate to the flow of funds and the use of funds.

Before lunch we were talking about over-utilized and under-utilized fields of taxation. There is another sort of animal that is referred to at the end of paragraph 52, and that is the types of taxes, the revenue from which normally changes cyclically, and which are subject to easy manipulation in counter-cyclical policies.

You also refer to taxes which provide for cyclically stable and steadily growing tax revenues. Would you describe the characteristics of these types of taxes, and tell us which they are? What kind of taxes are these that you have in mind?

MR. MACAULAY: Well, there are various taxes which, for example, respond in direct ratio to the product of the country, or of a province or whatever jurisdiction it might be, but one tax which has, perhaps, been a disappointment in recent periods of time, both in the United States and in Canada, has been the corporation tax. I should think this is a tax which one could very well say is related to the growth of an economy.

There are certain other taxes which are related in the same way. For example, the real estate tax, I would say, would be a tax which does not

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There are certain other taxes which are related in the same way. For example, the real estate tax, I would say, would be a tax which does not

respond to the financial cycles of a country in that it is related to assessment and the legislative capacity of a municipality. Whilst the municipality fixes the assessment and the rate on that assessment, the tax on real estate does not respond to the cyclical movements in an economy, whereas, I should think it is fair to say, a corporation tax does.

Now, within what area personal income tax falls is questionable, but I should think it is likely the former. In other words, the amount of work, the number of hours worked, and the pay that a person receives would result in a responding, bouncing yo-yo kind of a tax.

Whether there are others than the real estate tax, I do not know. Perhaps succession duties is another form of tax such as that. If I might be pardoned the pun, I will mention the liquor tax. If you look at the history of liquor revenue you will find it seems to be sustained at a fairly high level even at times of economic disquiet.

COMMISSIONER LEMAN: Yet am I right in thinking that mostly during the last ten years or so the provinces have been putting pressure on the federal government for a larger share of personal income taxes and corporate taxes?

MR. MACAULAY: I think it is right basically, because they have been faced with the fact, as Professor Triantis has said -- let me put it this way; the needs and spending of the federal government have not expanded at nearly the rate as have those of the provincial

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There is also the historic feeling that the provinces are entitled to a larger share of these fields than they are now enjoying.

COMMISSIONER LEMAN: I was interested also in your argument about the flexibility which you seem to think is built into the federal setup regarding its level of expenditures. The federal government is very much engaged in welfare payments, too, and some of those tend sometimes to require more money when there is a dip in economic activity, do they not?

MR. MACAULAY: Yes. The fact is, however, that in one day the federal government was able to announce a cut of $200 million in their budget, and that is something which I do not think is open to most provincial or municipal governments.

All I am saying here, without making an analytical review of the situation, is that a greater percentage of the provincial and municipal budgets and revenues is devoted to built-in situations over which we have less control than has the federal government.

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COMMISSIONER LEMAN: Yes, but defence requirements, from the point of view of the political and the international atmosphere, would not necessarily respond to the cycle in any way.

MR. MACAULAY: No, sir, but I think the point you were making to me was that the federal government is, perhaps, restricted in the same way that the provincial governments are in that they find it impossible to trim in the same way that we find it impossible to trim. I was just trying in an ad hoc way to point out to you certain areas in which I feel -- whether it is desirable or not, I do not know -- it is practically possible for the federal government to trim and where it is not practically possible to trim at the provincial level.

COMMISSIONER LEMAN: They get caught with your children when they get a bit older.

MR. MACAULAY: Do not look at me. I have only two.

Basically speaking, I do not think that their budgeting is as related as closely to the numbers in families as it is at the provincial level.

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I think this is the burden of about ten pages of this section, and I do not think I could distil it in fewer words.

COMMISSIONER LEMAN: Let me end up on this field with a very general question; do I read into what you are telling us that you would not, in general, be in favour of the use of fiscal policy as a counter-cyclical measure?

MR. MACAULAY: No, I do not think this, sir, with respect, would be fair. We think that fiscal policy and monetary policy generally must be utilized to the full in contra-cyclical budgeting, and we believe in contra-cyclical budgeting. What I am saying is that we are not against contra-cyclical budgeting, and we do not want to assume somebody else's responsibility. We want to be consulted, and we would like the federal government to realize that when they apply a policy we would like their arguments,

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if possible, to be more selective and more flexible so that there can be selective credit controls.

The Chief Justice has pointed out some of the problems involved in this, and I am sure we are all aware of these, but this does not mean that where there is a will there is not a way.

We have suggested in this brief ways in which these things can be done. We thought it would be a trespass upon your terms of reference if we went into this field too much. Perhaps this matter is more closely associated with the work to be undertaken by the Royal Commission on Taxation. But, nevertheless, we feel that this is an avenue which is thoroughly worth investigation.

I think you have been very gentle with us, and I would like to be very specific in relation to your questions, but I only want to point out to you that we are not asking you to find revenues for us. We are not asking you to find markets from which we can borrow. What we are asking is that you point out to the federal government the importance of investment in human capital and, secondly, the policies that they may place on themselves at the House of Commons level may have a very serious effect; that while a policy might help investment in physical capital it might also have a very serious effect that they are not aware of on our obligations which we feel -- maybe improperly so -- are more fixed than theirs are.

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COMMISSIONER LEMAN: We have heard from representatives of municipalities throughout the

country this week a proposal for the establishment of a Canadian municipal loan fund or bank under the auspices of the federal government. The purpose of this fund -- although I must admit its exact functioning was not thoroughly elaborated for us -- would be, generally, to make credit for municipalities much cheaper. It would have the credit of the federal government behind it. Do you have any comments to make about this ambitious plan?

MR. MACAULAY: I am sure you will have noticed that there was no reference made to it in our brief. The only observation we would have is that we are a part of the whole country, and if it is the opinion of the majority that a programme such as this is desirable then we would do nothing, of course, to stand in its way.

We also have the great concern that this cuts in both directions, even if the details, which as you have said are rather nebulous, at the moment are known.

We are anxious to do everything we can on our own behalf and on behalf of our municipalities. We have limits to our capacity. If we felt that this would not interfere with the responsibilities we have towards our municipalities, and that it would aid them, I would think we would be quite prepared to say that we would support such a programme, but we have not made it a part of our brief.

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57. There is something there -- I am not sure that I read the paragraph correctly, and I may have exaggerated what you are trying to suggest there, but it does seem to suggest to me that regardless of the cycle monetary policy is made subject rather to the financing needs of the federal government. I do not know whether you feel there is any evidence of that.

MR. MACAULAY: Well, I do not know that I want to stand and quote chapter and verse, but certainly the impression we have -- I think an objective observer would suggest, in view of the juxtaposition of the provinces and the federal government, and the aegis by which we can consult one another, and the relationship of the Bank plus its obligation to the federal government, that the odds are very high that what we say is correct.

Now, whether I can quote to you chapter and verse to establish this as in a court of law beyond all reasonable doubt is quite another matter. But, this is the impression that we have, and we think that the odds favour this conclusion being an accurate one.

COMMISSIONER LEMAN: You follow on from there with a recommendation that the provinces be represented on the board of the Bank of Canada?

MR. MACAULAY: Yes, sir.

COMMISSIONER LEMAN: Do you know that the board of the Bank of Canada already has built into it some regional representation across the country. I suppose that form of regional representation could

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MR. MACAULAY: Yes, sir.

COMMISSIONER LEMAN: Do you know that the board of the Bank of Canada already has built into it some regional representation across the country. I suppose that form of regional representation could

be done away with if the provinces were represented?

MR. MACAULAY: Is that a rhetorical question that you are asking me, sir? I do not know that I would want to be put in the position of proposing that the regional representation be done away with. All I am saying is that we do not feel there is a sufficient direct relationship or bearing upon the position of the provinces and the municipalities as such on the Board, and we feel that there should be. If this directly suggests that they should remove certain people who are there now, then I will say this is a conclusion we did not have in mind when we made that recommendation.

COMMISSIONER LEMAN: I wonder what would happen if the provinces were represented as you suggest. Would their representatives be able to recommend a temporary subjection of monetary policy to their financial needs?

PREMIER ROBARTS: Does not this get to the point you were discussing before lunch that this is really a question of means by which you know what is going on? Perhaps the ultimate answer would be the tailoring of some municipal and provincial needs to the overall picture.

MR. MACAULAY: And vice versa.

PREMIER ROBARTS: Yes. I think this is the point we had reached just before lunch.

MR. MACAULAY: Yes. It is a matter of communication. Very often a man upon whom the death sentence has been pronounced feels happier when he has

be done away with if the provinces were represented?

[illegible]

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MR. MACAULAY: Yes. It is a matter of communication. Very often a man upon whom the death sentence has been pronounced feels happier when he ha

been heard. This is the same feeling we have. I can acknowledge to you frankly, as I said this morning, that we did not have in mind a representative from every province. I am not sure that we have gone into the matter of how many, and so on. But, if we were to say that the relationship of the federal government and the Bank of Canada was such that the policies of the federal government and the bank were such as to augment and assist one another without sufficient consideration to the provinces, then it follows that we would like to have somebody at the foot of the throne, so to speak, to put in a word or two for the soon to be deceased, as we put it here.

COMMISSIONER GIBSON: When you mention a "representative of the province" are you thinking in terms of somebody who directly represents you and provincial interests? You are not thinking of putting somebody on who would not be well informed about provincial interests?

MR. MACAULAY: I would like to think you could have a man who had both qualities.

COMMISSIONER GIBSON: I would assume that such a man, if he is to be a representative of somebody else on the board ---

MR. MACAULAY: If you require an absolute answer on that I would say the basic requirement would be for him to represent the views of the province on the board.

COMMISSIONER MACKINTOSH: You do not

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MR. MACAULAY: If you require no absolute [illegible] to represent the views of the provinces on our board.

COMMISSIONER MACKINTOSH: You do not

necessarily mean that he would be an instructed delegate? There are people of varying experience on the board of the Bank of Canada, but they do not directly represent anybody nor are they instructed by anybody.

MR. MACAULAY: I would suspect that the person would have -- I do not know that the fact that a person directly represents somebody necessarily makes him also a delegate, but if it does I would be inclined to think that that is likely to be the point of view. To just add one more person to the board who could make recommendations against the interests of the provinces would not accomplish what we have been putting to the Commission.

COMMISSIONER LEMAN: To wind up a question I had, Mr. Macaulay, -- I do not want this to appear as if I am pointing to a contradiction in your brief; I just want to know which of the two points you prefer to emphasize. In paragraph 48 of your brief the last sentence reads:

> "In view of the importance of government revenues and expenditures, at all levels, in present-day Canada, reforms of credit institutions and policies must go hand in hand with a rational reorganization of our fiscal structure."

whereas in Part II of your summary there is this sentence:

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whereas in Part II of your summary there is this sentence:

"Improvements in the channels and effectiveness of business communication in the broadest sense are required more urgently than any change in the number and size of the financial institutions and their methods of finace."

Which would you like to emphasize?

MR. MACAULAY: Well, I would not emphasize either. I would like to insert the word "may" in the last sentence you used:

"Improvements in the channels and effectiveness of business communication in the broadest sense may be required more urgently than any change in the number and size of the financial institutions and their methods of finance."

In short, I do not believe in throwing the baby out with the wash. There is a tendency, when looking for new ways and means to do things, just to throw the baby out with the wash, sweep everything out that you have got. It very well may be that the size and number of the institutions that we have are most adequate. It may be that their effectiveness is lost somewhat because of a lack of communication. With great respect I hope that you will not feel, Mr. Leman, because I respond very quickly to the points that you are putting to me, that I would be on the defence in relation to this. I do not know that they are necessarily contradictory views.

COMMISSIONER LEMAN: No. I prefaced my question

"[illegible]

[illegible]

in the broadest sense are required more urgently than any change in the number and size of the financial institutions and their methods of finance."

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by saying I did not look upon this as a contradiction. I am just wondering about this. We heard earlier in the discussion that you felt that monetary policy at times has hit hard the provinces and municipalities, and I am wondering if you would ascribe all this strictly to the monetary policy as taken or whether you would ascribe part of it to the institutional setup we have in this country. Are you completely satisfied with this institutional setup, or do you feel that part of the difficulties are due to that?

MR. MACAULAY: I think the burden of our argument in our brief, in any event, has been on the policies rather than on the institutions.

MR. STEVENSON: That is true, with the exceptions we have mentioned.

MR. MACAULAY: Yes, with the exceptions we have mentioned.

COMMISSIONER BROWN: I have some questions with respect to a section of your brief dealing with the financing of small business. This is obviously a field in which we have considerable interest. We have heard quite a lot about this but there are several matters on which we would like the benefit of your advice, opinion and information. I start off by asking you if you would help us define a small business. This has been quite a problem in a number of briefs that have been presented to us. How do you define a small business, or what do you think is a satisfactory definition of a small business?

MR. MACAULAY: I think the implication of this

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MR. MACAULAY: I think the implication of this

morning was that there are a number of definitions, and obviously you were asking a question which gets right back to that, that a lot of people have different definitions of it.

My own definition of a small business, for what little it is worth, is obviously a different one than that adopted by, I think, D.B.S. ---

MR. STEVENSON: The Small Business Branch of the Department of Trade and Commerce.

MR. MACAULAY: --- or the Small Business Branch of the Department of Trade and Commerce, whoever the authority is. We have taken arbitrarily a figure of, let us say, 15 employees and we have said that more than 50 per cent of the manufacturing companies in Ontario employ 15 or less employess. Whether that is a good standard, I do not know, but it at least shows that if you did take that standard, 8,000 out of 13,000 fall into that category. When you get eight out of thirteen and you relate this to the number of employees, the capital, the new plant, taxes paid, and so on, this is a very sizeable proportion of your manufacturing complex.

I do not know, Mr. Brown, whetherthat is a very satisfactory answer. As Mr. Stevenson has said, the Small Business Branch of the Department of Trade and Commerce says that 90 per cent of Canadian businesses are small. Now, I do not know what standard they use. Mr. Stevenson, do you know what standard they use to come up with that figure?

MR. STEVENSON: No. They have used a variety, I think, but it is a slightly higher figure than 15 employees, if you take employees.

MR. MACAULAY: In the document which we prepared for the Prime Minister of Ontario in relation to some matters which we now have before the government, we describe small businesses as those whose needs for equity and loan capital are too small to interest business loan companies or to be marketed satisfactorily in the national capital markets.

This, of course, was directed towards the subject we were then studying.

COMMISSIONER BROWN: We are talking about the financing of small businesses, and I am sure you would not suggest that because they had 25 employees they were excluded from this problem.

MR. MACAULAY: No.

THE CHAIRMAN: How high do you go?

PROFESSOR TRIANTIS: This definition comes close to the definition of the Macmillan Committee which has defined small or medium-sized firms as being firms which require long-term capital in amounts "not sufficiently large for a public issue."

And if you go and look at the costs of floating an issue under a half a million to a million you will find -- I have some figures here -- in order to float common stock under half a million the cost is 27 per cent; under one million the cost is 21 per cent, and then from one to two million it goes down to $13\frac{1}{2}$. Beyond that it goes to 10 per cent or less.

MR. STEVENSON: No. They have used a variety, I think, but it is a slightly higher figure than 15 [illegible]

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I would say if you have to borrow a million or less your business is small.

MR. MACAULAY: You might be a sky-writing equipment company and your risks would be much too high. I do not think that you can tie it to that, as to what your undertaking is, but if we have to give a definition perhaps that is as good as any.

COMMISSIONER BROWN: You do not have to give a definition but you could help us with a definition.

MR. MACAULAY: Could you tell us, since we ourselves have bandied this phrase around on numerous occasions, what you consider to be a small business?

COMMISSIONER BROWN: This is a point we have not discussed yet. We are trying to get information and opinion on it.

MR. MACAULAY: I am glad to hear that we are not the only ones who cannot answer that.

COMMISSIONER BROWN: We have had quite a number of briefs presented to us dealing with this problem of small businesses. One at least said there was no problem in financing a small business. They were obviously in the business of financing small businesses and they felt there was no problem. There was another who said that 85 per cent of the problem was not a matter of finance but one of management. I notice you are preparing to develop in your Department something of assistance along this line. Some Canadian universities run extension courses for this. Do you do so in Ontario?

MR. MACAULAY: Yes.

COMMISSIONER BROWN: Do you support them financially in the province?

MR. MACAULAY: I do not think so, except we pay considerable grants to universities and in that sense we support them.

COMMISSIONER BROWN: Do you actively encourage this? In other words, do you recognize it as a problem?

MR. MACAULAY: Yes.

COMMISSIONER BROWN: When you get down to financing, you spoke in your introductory statement of the incidence of high taxes. This is probably getting on the fringes of a Commission other than our own, but I wondered, at the danger of so infringing, if you had any expression of opinion on whether the 21 per cent rate applies to the first $35,000 of taxable income? Do you think that amount should be increased?

MR. MACAULAY: I will tell what we have done, Mr. Brown. We have a group of economists with very fertile imagination. We did not feel we were satisfied with the tax position corporate-wise in the problem, and we sat down and came up with a number of incentive programmes related to more employees, ~~more~~ plant, more exports, different incentives as a whole. We have submitted these to the Treasurer. We feel it is our responsibility to sort of invent some of these things and he screens them and decides, between himself and the Prime Minister, what we will do in terms of these taxes.

We feel, whether 21 per cent or some other percentage is the point, that our basic problem is not directed towards the level of taxes. It may be that if the tax level were 25 per cent or 18 per cent they still could not. It is the smallness of them, coupled with taxation, which makes it difficult. Our real burden of our argument is to make possible funds for medium and long-term financing, other than those earned out of revenue.

I acknowledge I have not answered your question as to what percentage might be more desirable. Perhaps we have somewhat over-stated that particular sentence, but that is what it seemed to be to us at the time.

COMMISSIONER BROWN: In this field of long-term financing you have quite a lot to say about the I.D.B. In paragraph 75 you say:

> "At the present time it is difficult to know whether the I.D.B. is designed primarily to assist small business, to promote regional development or to advance industrial development in the less wealthy provinces."

I am sure that you all know that in the preamble to the I.D.B. reference is made to the financing of small enterprises. So, we assume that you have that at your fingertips, but I wondered what you meant by these other two. Do you think these other two should be included in the I.D.B. preamble? I should like to hear your comments on this. Obviously you have something in mind.

[illegible]

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MR. MACAULAY: The main point we have to make is there is a slip between the cup and the lip. As far as we are concerned, the I.D.B. may have a set of rules in the Act. You may vote another $1 million, $2 million or $3 million into a fund, but it is how you administer it in the long run that is going to determine whether you are going to use up that money and for what purpose it is used.

Now, all we are trying to do is to have a firm understanding amongst those who are doling out the money as to whether they are supposed to be aiding small businesses. It is my respectful submission that if that is their purpose, then they better take another look at what is a small business and what kind of requisites you can demand of a small business before you can lend them some money. I say this because I am singularly unimpressed by their effectiveness in this field.

All we are saying is that if the I.D.B. exists to aid small businesses, that is fine. If it exists to aid regional development, then that is fine. If it exists to bring industrial development to the less wealthy provinces, that is fine. But let us have everybody dealing with them, including those dishing out the money, know what they are doing, because I do not think they do.

COMMISSIONER BROWN: That is fine. Presumably you have some evidence to show that businesses are not getting supplied.

MR. MACAULAY: This is my opinion. Someone

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else may not accept it as evidence.

COMMISSIONER BROWN: We are endeavouring to get information. Have you any information other than opinion?

MR. MACAULAY: I think I have evidence of a specific instance. I do not want to refer to it here but I think I could find specific evidence for you. It is a pretty generally held opinion that the I.D.B. is not a development arm of the government but rather a banking arm of the government. If I could give you confidentially some examples, subject to the approval of the people involved, I would be prepared to do so.

COMMISSIONER BROWN: I think those would be useful. The other matter is that we have had people appearing before this Commission who want the I.D.B. to do more. We have had a number of representations to the effect that the I.D.B. is doing too much, that they are competing where they are not supposed to compete.

This arises particularly in the problem what are funds or credit that otherwise available on reasonable terms and conditions. We have had companies complain that they were lending money to enterprises, and I.D.B. came along and re-financed them. Now, this is obviously the problem. What should be meant by this term, "provided not otherwise available on reasonable terms and conditions"?

MR. MACAULAY: That is one of the problems we

had to consider, and I have not yet made my representations to the Premier and the Cabinet on this matter. But this is one of the things we had to consider. If we were to establish a fund we would not want to be in competition with the normal channels of lending institutions. At the same time, the mere fact that seven provinces have established such a fund and that in two or three years in Manitoba the Manitoba fund loaned more money in that province than the I.D.B., and that Roy-Nat has established itself in Canada, I think this is the kind of evidence that gives some indication that I.D.B. is simply not meeting its heralded purpose.

COMMISSIONER BROWN: I still get back to the point: What interest rate differential do you consider giving within this phrase of "reasonable terms and conditions"? Let us use figures. If the I.D.B. is prepared to lend at 6½ and somebody else is getting accommodation at 9, is that reasonable?

MR. MACAULAY: Mr. Brown, I want frankly to say to you that based on the experience I have had, and it is limited, and on the experience I have heard of, and it has been extensive, nothing is turned on the interest rate. What has turned on the interest rate has been the fact that loans have been turned down where there has been a darn good idea that might be beneficial for the development of this country but has not been within the traditional lending avenues or ambit of the traditional lending institutions. In the years in which I have some knowledge of this,

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the I.D.B. has decided that this sort of thing has not come within the letter of the Act. My own view is that the I.D.B. should be more concerned with the spirit of the Act.

COMMISSIONER BROWN: I was asking for your help and apparently you are not able to give us any.

MR. MACAULAY: I am sorry. I do not mean to avoid it, sir. I just simply feel that that is the aspect of the I.D.B. that I am most critical of, the development aspect where a fellow has a good idea. The interest rate is not the important thing. It is to get somebody to back him at all.

THE CHAIRMAN: Who is to decide it is a good idea? There are all sorts of ideas knocking around the country which might not be feasible. Who is to decide?

MR. MACAULAY: Is this quite correct? I can say to you that the attitude basically, as I believe it to be is that, "It is a great idea, old boy, but this does not fit the letter of the Act, namely, you are not able to put up enough equity. You have not got enough. Let me see your profit and loss statement" and that kind of thing. You cannot get a development going on the basis of a profit and loss statement.

THE CHAIRMAN: No, but you have to be sure there are reasonable prospects of managerial ability, and I should think there would have to be some financial responsibility, surely.

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MR. MACAULAY: Some financial responsibility.

with great respect, My Lord, and what in my opinion seems to be required, are some considerable poles apart.

COMMISSIONER BROWN: The Manitoba fund functions as a lender of last resort after I.D.B. has turned people down. Is it your proposal that your fund should operate on the same basis? Are you intending to compete with I.D.B.?

MR. MACAULAY: I want to say I do not know what we are going to do, for I am going to make certain representations and it will be up to the government to decide on the evidence that can be presented pro and con on the matter, as to whether we should get into it at all. I happen to be a great believer in small businesses and in development. When I press these reasons to them it will be up to them to make what decisions seem to be in the best interests of the province at the time. I would think, and as I envisage such a fund, it would be used after a person had proven that he had exhausted the capacities of the normal and conventional lending institutions to assist him. Then, having done so, he would have to show that what he was proposing was in the interests of development in the province both from the point of view of employment and the locality where we would like to see such development brought about.

COMMISSIONER BROWN: In paragraph 77 you start dealing with short-term financing, and at the end of paragraph 78 you say:

> "-- it would appear that in periods of credit restriction bank credit to small business is restricted proportionately more than credit to larger firms."

We have heard a good deal about this almost everywhere we have gone and it has been very difficult to come to grips with. It sounds very good in theory and on the face of it there is nothing wrong with the argument at all, but it is awfully difficult to get any evidence of it. Can you produce any evidence for us?

MR. MACAULAY: I do not know what analogy I should draw for you, but when a coloured person goes into a parking lot and it is perfectly empty and the attendant says: I am sorry, the parking lot is full, or; We cannot accommodate your car, what kind of evidence can you get? It is one of the difficult things in our society. I do not know how to prove any of these specifics.

COMMISSIONER BROWN: Let me ask you the question, can you give us any evidence where people who had a line of credit had it reduced?

MR. MACAULAY: I do not know that I cannot obtain it. I can perfectly frankly say that I do not have an example immediately in my mind, except that I will tell you that the Ontario Northland Railway, which is holier than thou to us in the

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province ---

COMMISSIONER BROWN: Even at 6 per cent?

MR. MACAULAY: Yes, even at 6 per cent. We have had credit at 4 million and 5 million, and we were told that a million dollars was the limit, as I recall.

THE CHAIRMAN: They did not regard that as small business.

COMMISSIONER BROWN: That is the point, we are discussing small business.

THE CHAIRMAN: Perhaps they did exactly what you intended they should do; they cut on the big and saved on the small.

COMMISSIONER BROWN: They should ask the big to go into the market so it will be available for the small. This is what we are trying to get at.

MR. MACAULAY: Well, anything I would say would be repeating what I have already said or what is contained in the brief.

COMMISSIONER BROWN: Well, now, in this connection you suggest raising the ceiling.

MR. MACAULAY: Incidentally, if I may interrupt, sir, I almost believe that to argue otherwise is to really get water to run uphill. From the arguments that we have used, and I acknowledge that I have not put specific instances at specific places at specific dates before you, but to suggest that something does not have to give during periods of tight money when a small business may be at 6 per cent and someone is at $3\frac{1}{2}$ per cent or 4 because

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COMMISSIONER BROWN: Mr. Macaulay, I would like to make it clear that I am not disagreeing with your argument or theories, I am merely asking you if you can help us by producing some evidence.

MR. MACAULAY: Well, I will tell you this, I will go home now by the first post and see what I can find.

PROFESSOR TRIANTIS: There are two ways of proving something. One is by witness and talking to people and the other one is by simple argument.

COMMISSIONER BROWN: I am not debating the argument, I am simply asking you to help us.

PROFESSOR TRIANTIS: We do not have to go and ask people if it is true if the argument stands. If you disagree with the argument here which the Minister has just dealt very, very briefly with, then we will need direct evidence. If a chap is not in a room there are two ways of proving that he jumped out the window. One is to see that he jumped out the window and the other is to show that the door was firmly locked. This is the second argument, that the door was locked and he must have jumped out the window.

COMMISSIONER BROWN: I am afraid I do not quite follow the parallel, but let us get on.

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MR. MACAULAY: We are a free thinking group, but in any event we will see what we can find.

COMMISSIONER BROWN: You talk about raising the ceiling on bank interest. I am not quite clear whether you want to raise it from 6 per cent to some other percentage or whether you want to get rid of it entirely.

MR. MACAULAY: No, I think we had in mind that getting rid of it entirely would be taking perhaps two steps when one would do. I think we had in mind raising it to a higher level.

I frankly would say to you, Mr. Brown, that we did discuss at some length whether the thing should be removed altogether. There has been a great tradition in the banking business, and I think when the ceiling limit was put on it seems to me that anything over 6 per cent was thought of as usury. Secondly, there was sort of a monopoly, and, thirdly, there was never the tremendous borrowings in those days that there are now. At least this is our impression. We thought at one time that it perhaps might be removed entirely, but we thought we would meet with less opposition if we suggested that it just be raised.

THE CHAIRMAN: In other words it is not a matter of principle, it is a matter of expediency?

MR. MACAULAY: I would not go that far.

COMMISSIONER BROWN: Well, is it fair to ask how far it should be raised?

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been broken, hasn't it, by RoyNat who are lending at 9 per cent? I do not know whether this is a target which is worth aiming at, but this is a combination of trust and banking companies which do not feel that this is too high a rate under the circumstances.

I think, going back to a question that you wanted me to answer, and I think I perhaps did not realize exactly what you were asking at the time, the fund such as I have been talking about should lend money at a little over the conventional lending institutions rates.

COMMISSIONER BROWN: In paragraph 83 down near the end you say:

"It may be necessary to provide for policies and techniques of selective control of credit."

I would like to ask you in this regard not so much what selective controls you would suggest, although if you have any suggestions we would be very pleased to hear them, but whether you see these controls as controls that stop certain areas getting credit, in other words making it available to certain areas, or is the type of control that you mention, one that makes it available to other areas? In other words, insulating certain areas?

MR. MACAULAY: I understand. I think it would be the latter rather than the former.

COMMISSIONER BROWN: In other words you would like something that would make credit available?

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the area in which it would more properly be. Then on the other hand I well recognize the argument that is made by many persons who have come up the hard way and have succeeded. They say: Why should you be lending money to these sort of fly-by-night organizations that cannot get it any place else? I have heard all sides of this thing over and over again, but I would think what we had in mind was something positive rather than something negative.

It may very well be that, although Mr. Gibson at your convenience and his will be able to instruct you otherwise, that the removal of the limit on borrowings may accomplish something of what we have in mind -- the removal of the bank interest rate, or the upping of it.

COMMISSIONER BROWN: That is all I have.

COMMISSIONER LEMAN: There is one thing I should like to get more clearly in my mind. The development funds of the other provinces are not necessarily specialized in the small business field, are they?

MR. MACAULAY: Oh, no. In fact, I think you could frankly say that if there is a fund in Quebec, its application has been in the very large field such as in steel.

COMMISSIONER LEMAN: And out West as well?

MR. MACAULAY: And in Saskatchewan, yes, I think, sir, this would be the most proper observation. However, I think it also fair to state that depending upon the market and location geographically of the

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institution involved that I think for instance it might be easier for a company that has been financed in Saskatchewan by the government, or helped through funds, might find it was possible to have done it by itself here in Ontario. Do you know what I mean?

It depends on a number of things; geographic location, how urgently the jurisdiction wants them to develop, and there are a number of factors that I think would enter into what kind of industry the fund would enter upon.

COMMISSIONER LEMAN: There is also a little detail in respect of which I should like to have the benefit of your experience, if you have been able to observe some concrete facts in this area. It comes back to paragraph 78 when you talk about short-term financing. In the extension of credit terms -- trade terms -- who do you think in general benefits the most when money gets tighter? What do you think is the general direction of the extension of terms?

MR. MACAULAY: Well, do you mean new loans extending existing loans or ---

COMMISSIONER LEMAN: No, I am talking about trade terms. Do you think in general that it is small business that is then more able to rely on suppliers who are generally larger businesses and, therefore, improve their working capital position by getting better terms when money is tight, or is it the other way around?

MR. MACAULAY: Do you mean by getting credit;

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MR. MACAULAY: Do you mean by getting credit;

that is they do not have to pay for 30 days or something of this kind?

COMMISSIONER LEMAN: Yes, trade credit.

MR. MACAULAY: As a matter of fact, Mr. Leman, you have raised inferentially a most interesting point. That is you infer from what you have said that small business basically is served by industry. Is that just what you have suggested?

COMMISSIONER LEMAN: No, I am suggesting that small business is largely the customer of big business.

MR. MACAULAY: Well, this, sir, we do not think is true.

COMMISSIONER LEMAN: Oh, they do not get their raw materials from larger enterprises?

MR. MACAULAY: Well, I am not talking about raw materials as much as I am talking about the end product, as to whether they are supplying a component for somebody else.

COMMISSIONER LEMAN: Have you been able to observe what happens when money gets tighter? Does small business get squeezed more in that field or does it get a little more accommodation?

MR. MACAULAY: I cannot tell you but I would think the tendency might be to give them more accommodation, but there again it is just theory.

COMMISSIONER LEMAN: If it were so it would be an offsetting factor?

MR. MACAULAY: Yes, indeed it would. It doesn't help somebody to establish themselves, however.

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COMMISSIONER LEMAN: Oh, no, not to start.

PROFESSOR TRIANTIS: But probably though it would be more expensive to borrow indirectly than from the banks.

COMMISSIONER LEMAN: Well, I think one could observe that in the last two or three years there has been over-all an extension of trade terms in Canada.

MR. MACAULAY: Yes, I think that was part of our argument too when we say that much is consumed that might not be were it not for credit no matter from what the source. I think that I would want to make one point, Mr. Leman, just before you leave it, in this exchange that you and I have now just had. We do not deny that small businesses are the customers of big businesses. All we say is that they are not the suppliers of big business to the extent that there is apparently some concept in many people's minds.

COMMISSIONER MACKINTOSH: I should like to ask you two or three questions about your section on consumer credit. You advocate disclosure of the financing charge, preferably, as I understand it, as a rate; a rate of interest.

MR. MACAULAY: Or range of rates, yes.

COMMISSIONER MACKINTOSH: Finance companies have argued that a good standard in their interest is full disclosure in terms of the cash price, the finance charge and any other incidental charges;

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the time price, the exact amount and number of instalments. They contend that the consumer understands a dollar amount better than a percentage amount, and that whatever he ought to be interested in, he or she is predominantly interested in the monthly charge. Now, we have had representations from the Consumer Association that they want a percentage disclosure. Everybody seems to agree that there is some doubt as to the mathematics of the price rate that is arrived at, but there does not seem to be any serious evidence that you cannot arrive at an approximate rate. Now, I take it that it is this approximate rate of interest that you think should be disclosed on every contract?

MR. MACAULAY: I think so, sir.

COMMISSIONER MACKINTOSH: It is not difficult to manipulate that rate. I do not mean to state it dishonestly, but it is relatively easy to put a little more on the price and a little less on the rate of interest and arrive at the same total result of the transaction, but that, of course, has to be disclosed. The question is, how many of the consumers are sophisticated enough actually to make a meaningful comparison?

MR. MACAULAY: The advantage it has, doctor, it seems to me is this, that if you say it is subject to certain manipulation and somebody puts their rate up, it immediately makes it possible for that person to have chosen some other source of supply to start with, because he is now being charged more

than he would some place else. Now, if the interest rate is then lower than some place else he has at least an alternative. Two of the tendencies I have noticed are; one, to sell in terms of a package deal and another -- I do not know how general it is, whether it is ubiquitous or not -- there is a tendency for some people just to buy something, sign up, and all the details get filled in a little later on the card when it is being handed over to the finance company. Now, there is a great deal more of that than you may have had evidence of here.

I only say this because it happens that every Wednesday evening for twelve years I have conducted what I call a free legal aid clinic in my constituency. I have seen over thirteen thousand people myself, and I can say that 25 per cent of them are involved in car transactions, and I would say also that more than half of them are involved with people who have them sign up, and have the details filled in afterwards when it has been handed over to the finance company. Now, you have asked for examples and I am just able to give you very many in this case. So, I do not know whether you have seen this in the case of Mrs. Sammy Glutz when she tells you what happens, or if you are seeing a different group of people, but I am speaking for Mrs. Sammy Glutz and I can tell you there is a lot

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of filling in that goes on afterwards. Now, whether you can stop that, I do not know, me having said it, but there you are.

COMMISSIONER BROWN: Is this a selective control you are suggesting?

MR. MACAULAY: Well, I do not know what I am suggesting. I likely just wasted three minutes ofyour time.

COMMISSIONER MACKINTOSH: No, I think that is valuable evidence. The larger companies insist that they have a standard form and their policy is that all these items be disclosed.

MR. MACAULAY: But, sir, look; there is an awful lot that is purchased that the finance companies finance in respect of which when the form gets to them everything is disclosed, but there is a lot of signing up done without much disclosure. Now, there are several Bills at the moment pending before our House; at least one that I know of directed to this particular point -- private members' Bills, but there is an apprehension, and there is a feeling that: Well, what harm can it do and, if it may do some good isn't it worth considering. Whether this is a meritorious approach to take in this matter I do not know.

PREMIER ROBARTS: You can draw an analogy here to the provisions of our various securities Acts where we require disclosure, for instance, in prospectuses and we cannot guarantee that everybody is going to read it, but nonetheless we do require disclosure.

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COMMISSIONER MACKINTOSH: In any properly arranged deal the customer should have a copy of the form he signs. You also say in this section that you think it is not desirable to exert or to assert any additional legislative controls over financial intermediaries. Are you referring there specifically to finance companies or are you including trust and loan companies, and so on?

MR. MACAULAY: Well, I don't know. I think our basic purpose in preparing this was to saddle the general public with as little more or additional legislation as was necessary.

There are people, you know, who make both a vocation and an avocation of interfering in other people's business. We try to approach this from another direction. We don't have anybody specifically in mind, do we?

MR. STEVENSON: There was no intention to.

COMMISSIONER MACKINTOSH: You point out also that you observed a gap resulting from the Small Loans Act and that there are very few loans made between $1,000 and $1,500 because apparently the interest ceiling is too low, and you think it would be important if that interest ceiling were raised.

My recollection of the history of this is that the size of what is called a small loan has been increased historically; that it was originally something like $500, but it has gone on up and this would seem to indicate that the size is a little large for the actual practice, if they were to cut it

COMMISSIONER MACKINNON: [illegible]

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My recollection of the history of this is that the size of what is called a small loan has been increased historically; that it was originally something like $500, but it has gone on up and this [illegible] large for the actual practice, if they were to cut it

off at $1,000 and leave the $1,000 and $1,500 rate free, and then presumably you would get business done in this bracket?

MR. MACAULAY: Except that he is making a small loan of $1,600; there seems to be no problem from $1,500 up and no problem from $100 to $1,000, but there is a problem in this particular area.

COMMISSIONER MACKINTOSH; He is not controlled from $1,500 up.

MR. MACAULAY: Oh, I see. Have you got some comments?

MR. RICHMOND: This was simply a matter of statistical fact which we discovered, and it has been mentioned in various circles that either the Act should extend above $1,500 or we should do something in this intermediate area to open it up so that they will make loans. There is nothing specific there except to take a look at it.

COMMISSIONER MACKINTOSH: I don't know whether any of the others have questions to ask about this.

COMMISSIONER BROWN: There is one question, and that is whether as a result of the action taken by the Ontario Court of Appeals -- which came after you prepared your brief -- you want to make any recommendations about interest rates?

MR. MACAULAY: It is subject to appeal, that is all I can say, that is the Unconscionable Transactions Act.

COMMISSIONER BROWN: Yes.

MR. MACAULAY: It is subject to appeal, and

I don't know that -- have you got any comments to make on this? No.

THE CHAIRMAN: You can't make any comments upon the merits of it or otherwise?

PREMIER ROBARTS: Perhaps we can put our position this way; if the appeal is not successful, we think there should be legislation that will stand the test.

COMMISSIONER BROWN: That is what we wanted to get on the record. Thank you.

THE CHAIRMAN: It might have to be federal.

PREMIER ROBARTS: It might very well have to be federal.

MR. MACAULAY: It would be much cheaper to win the appeal!

COMMISSIONER MACKINTOSH: You are extending the price economy too far!

If I could turn now to the next section on the financing of exports. One of the striking sentences is the statement that the question is how we can give Canadian exporters better terms which will assist them in capturing new markets. In what way do you consider what is called the Export Credits Insurance Act inadequate, and what would you like to see added to it?

MR. MACAULAY: One thing was added recently or, in any event, it has been announced that the Export Credit Corporation will grant credit directly to foreign governments. This was, as I understand it, something that was not available before and in view of the fact that as I said this

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morning one third of the world is under the domination of Communist regimes, and they represent a large market, we can't ignore that it may well be more attention should be given in this area.

COMMISSIONER MACKINTOSH: My recollection is that they have also increased the limit on loans or, rather, that they may be in the process of doing it.

MR. MACAULAY: And I think they have voted some more money to the fund.

COMMISSIONER MACKINTOSH: That is what I meant.

MR. MACAULAY: As I implied, however, the voting of more funds, more money to a fund, the size of the whole going into it isn't nearly as important as the size of the whole going out of it, if you know what I mean, and if they don't change their terms of reference -- I don't know whether they have used it, but certainly in the case of I.D.B. they have by no means exhausted the tremendous funds that they have on hand, if loading means anything.

COMMISSIONER MACKINTOSH: In what respect do you think their terms ought to be changed?

MR. MACAULAY: Well, as we explain in this brief, the tendency in the past has been to have untied loans, and untied loans or credit is normally done in the field of 60 days, 90 days, a year, two years, 36 months, or whatever it may be, and once you get into the field of engineering and sort of immense things like a nuclear reactor for

India or a dam for Egypt, or some of these technical studies that have been done by Canadian companies in the banana republics, you may be getting into 25-year term stuff, and we feel that the length of the period for credit is now a characteristic of the transaction and that it may very well be that this is an area that your Commission should seriously look at to see whether the length of the terms should be extended.

COMMISSIONER MACKINTOSH: On your earlier reference to untied loans, the insurance part of the Act covers the transaction, there is no question of it being tied or untied, it relates to the specific export contract, and I think you will find that all the loans relate to specific export proposals, so that they are in effect tied loans; they are not money given to a foreigner to spend as he pleases.

Your other point, that they haven't perhaps got into long enough periods for some classes of exports is a point to be considered.

MR. MACAULAY: Well, doctor, I am afraid then I have failed to distinguish clearly, because of my inability of definition, between tied and untied transactions.

A tied transaction is when a man will buy only if he can get credit. An untied transaction is when he buys but the seller may be able to negotiate, apart from the purchaser, some kind of credit.

COMMISSIONER MACKINTOSH: The use of tied and

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COMMISSIONER MACKINTOSH: The use of tied and

untied loans that I was familiar with was quite different from that.

PROFESSOR TRIANTIS: The brief doesn't complain that the loans are not tied; we are just showing the development of credit in the national field as compared with the past. What the brief is suggesting, and I think the emphasis is on this term "better terms", , is that there has been a study by the Canadian Trade Committee showing that the Canadian exporter gets just as good terms as the exporters in other countries. We want to put the emphasis on the fact that that is not enough; we want to be a step ahead because of the importance of export trade for Canada, so it is not enough for the Canadian Trade Committee or anybody else to say that the Canadian exporter gets as good treatment as the German exporter, where export trade is not as important. That is a fact, and we should always be a step ahead.

MR. MACAULAY: That is the point which we are trying to make.

COMMISSIONER MACKINTOSH: Where does this lead you?

MR. MACAULAY: Well, it means that people are constantly trying to catch up with you, I guess.

PROFESSOR TRIANTIS: You either have to be a step ahead or go behind, and we can't do that, we have to be a step ahead.

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PROFESSOR TRIANTIS: You either have to be a step ahead or go behind, and we can't do much, we have to be a step ahead.

MR. MACAULAY: We have a greater dependence upon exports than so many nations; in any event, we

have a large dependence upon them and if we are able to , and since we are developing an area of tied transactions and the quality of one's goods and the price are no longer the sole criteria as to whether the sale will be made, therefore if we can offer little better terms by way of credit we will really be able to make the sale. I think this is the point we are trying to make.

Where it leads you or how far we have to be ahead, I don't know, but our respectful submission is that it is incumbent upon us to look at the terms which we offer and the terms other nations offer and see if there is any way in which we can better them. In short, we shouldn't just respond to the fact that somebody is running ahead of us all the time; it may be well worthwhile looking to see if we can get ahead of somebody else.

MR. STEVENSON: I think that the history of the past four or five years has perhaps justified this. I think four or five years ago it might have been said that this country was slightly behind some of its leading competitors in the terms it could offer, but since then I think a number of measures have been taken to bring things into balance again.

COMMISSIONER LEMAN: Is it the country that has the most capital to export that wins this race in the end?

MR. STEVENSON: It could be.

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recommendations we have had from another group has been that it would be applied all to Canadian construction contracts abroad, even though they involve no Canadian materials and comparatively little in the way of engineering services. It seems to me to be perhaps a moot point, though doubtless valuable to construction companies.

MR. MACAULAY: Just on that point, if I may; there are two ways in which we will correct our imbalance of payments, one is by selling an object and getting cash back, and another is by doing something some place outside of our country and getting cash back, dividends, interest, royalties, agency fees, or something else.

Now, if by financing something we are going to get cash back, and we have some reasonable security in relation to what we are financing, this is then one of the significant ways in which we will correct the balance of payments. If one of our long range programmes is the reasonable balance of payments over a number of years, then it may well be that this -- whether it is a moot point or not -- is worth looking at.

COMMISSIONER MACKINTOSH: That is what I meant by a moot point; it was worth discussing.

MR. MACAULAY: Oh, I am sorry.

COMMISSIONER MACKINTOSH: It turns on how much service there is in the contract.

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is involved in that I have no immediate judgment on. Have you any specific things in mind in urging such arrangements for providing credit or guarantee facilities to Canadian producers who will replace imports?

MR. MACAULAY: Well, it may be that this field is basically a tax incentive field. There are a number of ways in which you can approach it. You can approach it on the grounds, perhaps, of companies who employ more labour than over a standard base on an earlier period. It might be the persons who put increased plant into operation over a standard base of an earlier period. It might be people who can distinguish the kind of operation that they are now undertaking to show that they were directing it at a replacement of something which was high on the import list. It may be in terms of simply giving them a greater write-off. I am not sure.

We have prepared a number of submissions -- we are full of submissions -- on tax incentives and you see, frankly, this tax incentive business, it is like giving away anybody else's money; you are limited only by your own imagination -- subject to the approval of the Premier, I mean. I think this may be beyond your purview, but we would like you to consider this as a problem because, quite frankly, people can talk all they like about correcting the balance of trade in this country, but until we

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actually make a sacrifice about doing something in terms of our imports, then we will be in the dark, in my opinion.

Now, we have a problem; we don't export enough and we import too many things which we could well make in this country. I don't think we should cut them out; we should cut them down. If we can't get people to do it by their own initiative, it may be that we will have to encourage them to do so. I think at least this is something -- or, I hope it is something -- which your Commission would look at, and we hope that you will come up with something even more fertile than the eight different approaches which we have taken. You have this advantage, you don't have to get the Premier to approve it!

COMMISSIONER MACKINTOSH: For the moment the shift of, say, 12 per cent in the exchange rate, plus 10 or 15 per cent surcharge gives quite a good ---

MR. MACAULAY: But that is a very nebulous kind of thing, because in every paper you pick up something has been knocked off the surcharge list, and it runs counter to the spirit of GATT, and every country has been agitating that the entire thing be removed. We may get to the stage where we will be embarrassed by our own riches, and the Federal Government may/not be able to hold the dollar down to 92½ cents, although I assume that this may be sometime after, but it is a problem.

COMMISSIONER MACKINTOSH: The Commission doesn't entertain any suspicions on the stability of the exchange rate.

MR. MACAULAY: With great respect, I don't think we should predicate an export programme or an import replacement programme in the future on something as unstable as the value of the Canadian dollar or the impost fees. I think it is not a sufficiently strong belief in the concept of our own national virility that we should have to rely on these artificial stimulants to get our people up off the chair.

COMMISSIONER MACKINTOSH: If you assume that the Canadian dollar is unstable, what good are your incentives?

MR. MACAULAY: I don't mean unstable, I mean variable.

COMMISSIONER MACKINTOSH: Assume it is variable, what good are your incentives if they are going to be offset?

MR. MACAULAY: This may be so, but I have great faith that it will be extended in the sense that it will keep climbing rather than dropping further down.

COMMISSIONER MACKINTOSH: Well, I will stop on that note.

COMMISSIONER GIBSON: Mr. Chairman, following on the same thing, from the standpoint of stimulating and the standpoint of the general health of the economy,/you like the fixed exchange rate or the
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variable exchange rate or a free exchange rate, let us say?

MR. MACAULAY: I frankly don't know that we have studied this point, and in view of that fact, that there are a number of opinions on it, I would certainly want to consult with the people I am with before I answer.

My own view is that I wasn't very pleased with the bouncing exchange rate not when it was fixed as low as it is, but I am inclined to think that in our own country we are better off to try a pegged exchange rate.

COMMISSIONER GIBSON: Don't you think, as Dr. Mackintosh suggested, that the current rate should have substantially stimulating factors?

MR. MACAULAY: I don't deny that, but I don't think there is any permanency in this kind of a thing, and what I am trying to do is to create an atmosphere of competitiveness in our people and in our province; a desire to help themselves other than by artifical means, and I must admit, I suppose, that you may say incentives are artificial; this is the part you are getting at, so I must admit you box me in.

COMMISSIONER GIBSON: That was very quick. I was very interested in the analysis in this last section on balance of payments, import capital. It is section 43. The analysis here ---

MR. MACAULAY: I am sorry, Mr. Gibson, what paragraph, sir, are you referring to?

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COMMISSIONER GIBSON: I will refer to

paragraph 114 in particular, which is on page 44. The area here is on pages 43 to 46. The suggestion here is that our dependence upon foreign capital may not diminish very much in future.

MR. MACAULAY: Quantitatively.

COMMISSIONER GIBSON: Pardon?

MR. MACAULAY: Our dependence on foreign capital may not diminish very much quantitatively, but it may vary qualitatively.

COMMISSIONER GIBSON: Yes. I just wanted to get exactly what you meant by that. You mean that we are looking forward to running a big current account deficit for a long way ahead. I heard you say you thought we had to gradually cut this down, and yet a need for capital means a big deficit?

MR. MACAULAY: Not if it is accompanied by a major export effort or licensing, royalty or other agreements which will give rise to income coming into Canada.

The fact that we may rely on foreign capital doesn't necessarily imply an imbalance, and it depends on what the foreign capital is invested in. If it is invested in equities which go on forever creating dividends, this is one problem, but if it is invested in municipal or federal or provincial bonds which have an end unto themselves, and no control being involved in them, this is another matter.

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So unless one qualified the kind of investment the money is going to go into, and that kind of thing, I think it is hard to assume that by encouraging or even bringing about foreign investment in this country we will necessarily produce any worse position than we are in at the moment.

COMMISSIONER GIBSON: I am not questioning the point about the desirability of importing foreign capital, but if you have a net import of foreign capital then you must have a net deficit on your current account.

MR. MACAULAY: Yes. I am sorry. I thought you meant just an investment of foreign capital. I missed the word "net" there.

COMMISSIONER GIBSON: If you get a capital import net you must have a current account deficit.

MR. MACAULAY: Yes, sir.

COMMISSIONER GIBSON: And I take it from what you say that you feel very strongly that we should be working towards reducing this deficit.

MR. MACAULAY: Yes, sir.

COMMISSIONER GIBSON: What are the implications of that? What are the implications of reducing the debt? If we find it convenient and stimulating to have a significant amount of direct investment from abroad in new industries, and that kind of thing, and if the provincial governments and municipalities find it economical to borrow abroad in a sizeable way -- these are the two elements in the import of capital upon which you put some

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MR. MACAULAY: Well, with respect, Mr. Gibson, I do not really feel that those objectives are incompatible.

COMMISSIONER GIBSON: They are statistically. It depends upon what meanings you put on words.

MR. MACAULAY: No, with respect, I do not think that statistically they are, unless you leave out another essential ingredient, and that is a real major thrust in terms of exports.

COMMISSIONER GIBSON: That will earn you more income and help you to balance your current accounts?

MR. MACAULAY: Yes.

COMMISSIONER GIBSON: So will your royalties.

MR. MACAULAY: Yes, but it helps to leave us in a less unbalanced sort of a deficit situation. Thus, in the years ahead, I think you can work towards a lessening of the difference between the amount of cash coming in and the amount of cash going out. Even though you are a big importer of capital you may become an increased exporter of hard goods which will return to you more cash.

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COMMISSIONER GIBSON: You will be an exporter of capital?

MR. MACAULAY: You might be, sir. You might be an exporter of capital.

COMMISSIONER GIBSON: There is one other point. Going back to consumer credit your brief says that apart from measures having to do with conditional sales contracts, etc., that you did not see any need for specific controls or regulations over matters that affect the financial intermediaries that are engaged in such transactions. Earlier on in your brief -- and this is a point that puzzles me a little -- there is quite a little emphasis placed upon selective controls, and the three areas specified as being areas which were not, perhaps, much affected by tight money were, as I remember it, inventories, sales of consumer durable goods, and land speculation. Now, the sales of consumer durable goods are usually made under conditional sales contracts. What kind of selective control do you envisage there?

MR. MACAULAY: I think you are suggesting that there is a contradiction in the fact that we are saying no legislation ---

COMMISSIONER GIBSON: No, I am asking for enlightenment.

MR. MACAULAY: Superficially, it sounded to me as well that there was a contradiction, but I think really what we had in mind was that there was no need for more legislation to control the morality of a consumer transaction, but that we may need to have selective controls as to what credit

MR. MACAULAY: [illegible]

be an exporter of capital.

COMMISSIONER GIBSON: There is one other point. Going back to consumer credit your brief says that apart from measures having to do with conditional sales contracts, etc., that you did not see any need for specific controls or regulations over matters that affect the financial intermediaries that are engaged in such transactions. Earlier on in your brief -- and this is a point that puzzles me a little -- there is quite a little emphasis placed upon selective controls, and the three areas specified as being areas which were not, perhaps, much affected by tight money were, as I remember it, inventories, sales of consumer durable goods, and land speculation. Now, the sales of consumer durable goods are usually made under conditional sales contracts. What kind of selective control do you envisage there?

MR. MACAULAY: I think you are suggesting that there is a contradiction in the fact that we are saying no legislation ---

COMMISSIONER GIBSON: No, I am asking for enlightenment.

MR. MACAULAY: Superficially, it seemed to me as well that there was a contradiction, but I think really what we had in mind was that there was no need for more legislation to control the morality of a consumer transaction, but that we

[illegible]

is given during certain periods of time. With respect, I do not think those two points are contradictory. Is not this the point?

MR. STEVENSON:

We would like to see the rate of interest stated in this way, but we do not want to impose anything else on these finance companies.

MR. MACAULAY: That is by having them fill out different forms, and such other nuisance legislation.

PROFESSOR TRIANTIS: I wonder if the consumer wants this sort of statement in the contract. As Dr. Mackintosh has said, why on earth would the finance companies not supply that information just to please the consumer. But, the consumer is asking for something more.

MR. MACAULAY: Is he really, or is it just that a number of people are asking for it -- people who are trying to be busy.

PROFESSOR TRIANTIS: It seems there is something fishy. Why will the finance companies not do it?

MR. MACAULAY: But, is the consumer really asking for it, or is it somebody who is trying to keep busy by thinking of things to do who is asking for it?

COMMISSIONER GIBSON: On this question of consumer credit controls have you any particular thoughts as to provincial activity in this field?

MR. MACAULAY: Do you mean as to morality or to disclosure ---

COMMISSIONER GIBSON: No. I do not know

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MR. MACAULAY: Do you mean as to morality [illegible]

COMMISSIONER GIBSON: [illegible]

whether there is a constitutional problem involved here, or not. There might be.

MR. MACAULAY: It sounds as if there might be. It is likely to come in under banking or interest rates.

PREMIER ROBARTS: I think our assumption has always been that there is.

COMMISSIONER GIBSON: That there is a constitutional problem?

MR. MACAULAY: Yes.

PREMIER ROBARTS: That it is not within provincial jurisdiction. This is the point that is, in fact, before the courts today with respect to the Unconscionable Transactions Relief Act.

THE CHAIRMAN: I am not so sure. I think this is a different point.

COMMISSIONER MACKINTOSH: May I venture a lay opinion that the disclosure of the rate of interest without any attempt made at controlling the rate would be pretty clearly within provincial jurisdiction.

MR. MACAULAY: I would have thought so. I was going to say, Mr. Gibson -- perhaps the Rowell-Sirois report should not be raised here, but if we have in mind the development of this country and any reasonable flow of investment moneys from outside as well as from our own jurisdiction, I think it would be unfortunate if all the provinces got into this business of credit restrictions, and so forth. That would have a balkanizing effect on Canada, and I think we have tried in this brief to show you that we are not here to grind any axes. We are trying to bring things before you that we think will be helpful to our province.

COMMISSIONER GIBSON: The only reason I

asked this question was because the only time the federal government has exercised any control in this area of consumer credit has been in emergency conditions such as during the war and the Korean crisis.

MR. MACAULAY: Perhaps they felt that those were the only times they could politically justify it, but that does not mean that that is the only legal time they could have brought it about.

COMMISSIONER BROWN: I have one question I would like to ask about foreign investment. Do your recommend the removal of the withholding tax on provincial and municipal bonds? If my recollection is correct, the withholding tax has applied for a long time on Canadian pay municipal issues. The new imposition was only in respect of American pay municipal issues. So far as the municipalities are concerned, what I would like to have cleared up is what your recommendation is. Is it your recommendation that it be removed entirely, or removed from those to which it did not apply prior to December of 1960?

MR. MACAULAY: I think we would rather remove what we have called the thinly excusable restrictions which discouraged investment by persons beyond our borders in our provincial and municipal issues. I would think we are inclined towards the removal of whatever kind of withholding taxes there are. Is this right?

PROFESSOR TRIANTIS: Yes.

COMMISSIONER BROWN: The other point I would like to ask you about is with respect to

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COMMISSIONER BROWN: The other point I would like to ask you about is with respect to

institutions. We have heard from the trust companies, from the credit unions, from the Quebec Savings Bank, and so on, but we have not heard from the Ontario Savings Bank. I understand our research staff is getting some information for us, but I wonder if you could outline to us the policy that is followed with respect to the Ontario Savings Bank. Are these funds used for any specific purpose? Does the interest rate vary with the monetary policy? Does the interest rate go up when other interest rates go up?

MR. ALLAN: We have followed the policy of paying the same rate of interest on savings deposits that is paid by the chartered banks. The difference in our policy is that we pay that interest on a minimum monthly balance, which gives the depositor a little advantage over the depositor in a chartered bank. Our savings remain fairly steady at between $70 million and $80 million.

Now, when the bank was established many years ago, I understand that at that time there was thought of using the funds for some particular purpose, but during later years those funds have been available for the use of the government and they have furnished loan capital, really, to the government at an interest rate that has been satisfactory to the government.

COMMISSIONER BROWN: In other words, they have not been used for any of these other ancillary purposes?

MR. ALLAN: They have been used for general government purposes.

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COMMISSIONER BROWN: In other words, they have not been used for any of these other ancillary purposes?

MR. ALLAN: They have been used for general government purposes.

MR. MACAULAY: There have been all kinds of recommendations made that they should be used for development and investment in this kind of thing, and that, but the difficulty is -- I think the experience was during the 1930's that it becomes very difficult when the money is, in effect, there on demand, to have it placed in and out of solid concrete forms. Is not this right?

MR. ALLAN: Well, the judgment has been, during later years, -- and quite a number of years -- to use those funds in the way I have indicated.

COMMISSIONER MACKINTOSH: May I just interject one thing. Your mention of the 1930's reminded me of it. There seems to be a lot of opinion that foreign equity investment is disadvantageous at the present time. In the latter part of the 1930's the great complaint was that foreign investment was all fixed term and, therefore, a dead weight not dependent upon earnings, and a tremendous burden on the economy. We may find in the 1970's that we are back to the earlier concept.

MR. MACAULAY: I do not think you will find that we have said that. We have said it should be mixed. We have asked you to emphasize the advantages and the disadvantages.

COMMISSIONER MACKINTOSH: I was not referring specifically to your brief, but to some of the other discussion we have had. I am old enough to remember some of these things, and I am even encouraged at finding the government of the province of Ontario

seeing something worthwhile in the Rowell-Sirois report.

THE CHAIRMAN: That concludes the discussion, gentlemen. We appreciate very much your presence here, and the contribution you have made. You have been of great assistance to us. Your remarks have been not only instructive, but at times they have been decidedly colourful.

PREMIER ROBARTS: May I thank you, sir, for your kind attention to our submission. We have enjoyed presenting it to you.

THE CHAIRMAN: We shall adjourn now until Thursday morning next at 9.15 to hear the submission of the Broker-Dealers' Association of Ontario.

--- Adjournment.

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Royal Commission on Banking and Finance

THE GOVERNMENT OF ONTARIO

Hearings held at OTTAWA

Vol. 51A

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Toronto, Ont.

SUBMISSION OF THE GOVERNMENT OF ONTARIO

TO THE

ROYAL COMMISSION ON BANKING AND FINANCE

OCTOBER, 1962

Presented by

Hon. John P. Robarts

Prime Minister of Ontario

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SUMMARY

I

The overall function of Canada's financial and monetary system and policies, or for that matter of our whole economic system, is to achieve a satisfactory rate of economic growth, full employment, stability of incomes, and an equitable distribution of the national product. Among the intermediate objectives in achieving our basic goals we include stability of prices, economic flexibility and well balanced trade and payments relations with the rest of the world. It is the view of the Government of Ontario that the over-riding goal of economic and financial organization and policy should be economic growth, and that the chief test of the structure, functioning and policies of our financial and monetary system must be the extent to which it has and can serve this important goal.

The other goals of course cannot be neglected. Decision on the desirable mix of goals to be pursued is a difficult one. It involves political and ethical, as well as economic considerations. It would seem clearly desirable from time to time to have a public announcement by the Government of Canada of the particular combination of goals at which the economy is aiming. Such an announcement would serve as a beacon of the direction in which public policy is leading the economy, and would place any public discussion about the feasibility and desirability of

the combination chosen on a firm basis.

In any event, we recommend that the Government of Canada state explicitly that economic growth is the primary economic goal of the Government of Canada, and that this goal should be specifically stressed in the preamble to the Bank of Canada Act. Further, we consider it imperative that the relationship between the Government of Canada and the Central Bank be clarified with respect both to the responsibility for chosing the goals of monetary and related policies, and the ultimate responsibility for the policies used in pursuing the chosen goals. There should be no shadow of doubt that final decisions in these matters rest exclusively with the Federal Government.

II

The Province of Ontario is of the opinion that there is a growing need in Canada for an independent and national in scope institution of economic and business research. We strongly urge the establishment of a National Institute for Economic Research. The Government of Ontario is prepared to cooperate in a private or public venture in order to create such an organization.

The Government of this Province has come to the conclusion that more effective channels of business communication are needed for the adequate functioning of our economy. This point was brought repeatedly to our attention in the preparation of this submission. Improvements in the channels and effectiveness of

business communication in the broadest sense are required more urgently than any change in the number and size of the financial institutions and their methods of finance. We ask your Commission to emphasize this problem and to give full consideration to ways by which improvements may be achieved.

III

In our brief we have stressed at length the importance of investment in human capital or intangible assets in contributing to increases in productivity and economic growth. We have indicated that studies carried out in the United States suggest that the return on human capital in the form of investment on education has been at least equal and has probably exceeded the return on investment in physical capital. We urge that your Commission emphasize the tremendous importance for economic growth and social progress of investment in human capital.

Investment in human capital - public expenditures on health, welfare and education - is one of the chief responsibilities of provincial and municipal governments in Canada. We cannot help stressing that Canadian economic growth will depend in the future on substantial increases in provincial and municipal expenditures on these services, and there is every indication that the share of public expenditures on education and health in the total national expenditure will expand very considerably in the foreseeable future.

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these items will place on our tax revenues are of first importance if we are to achieve our goal of promoting a satisfactory rate of economic growth. In the course of the submission, we consider the problems associated with the growing responsibilities of provincial and municipal governments and the type and nature of their tax revenues. We urge that your Commission consider fully the problems of provincial and municipal finance and the possible repercussions the continuance of the present unsatisfactory situation of inadequate provincial and municipal revenues will have on Canada's future. Questions of availability and cost of credit to provincial and municipal governments are closely related to the nature, volume and flexibility of tax revenues. In view of the importance of government revenues and expenditures at all levels in present-day Canada, reforms of credit institutions, methods and policies must go hand in hand with a rational reorganization of our fiscal structure.

The nature of the bulk of expenditures which the province and the municipalities will be called upon to make in the coming years draws attention also to the problem of short-run fluctuations in their revenues. It is obvious that a short-period decline in the rate of growth of total financial resources of provincial and municipal governments might require drastic restrictions on the expenditures of these governments in important areas of social and economic development. We suggest that your Commission examine on the one hand the variability of the various public

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expenditures of the three levels of Government as they relate in the short run to economic stability and in the long run to economic growth, and on the other hand, the cyclical variability of the various tax revenues. We recommend that adjustments in the distribution of tax revenues be made between the various levels of government which would facilitate the need of provincial and municipal governments for cyclically stable and steadily growing tax revenues. The Federal Government would then have control of those taxes whose revenue normally changes cyclically and which are subject to easy manipulation in contra-cyclical policies.

In order to promote federal-provincial cooperation in the development of contra-cyclical policies we recommend that machinery be devised for regular consultation between the Federal and Provincial Governments on the state of the Canadian economy and the possibility of concerted governmental policies to promote economic stability and growth. Total provincial government expenditures have become as important as the expenditures of the Federal Government.

The Province of Ontario is convinced that changes towards a policy of tight credit affect the finances of provincial and municipal governments and investment projects considerably more than they affect the financing of business investment. In our view, short term changes in the supply of credit for financing investment in human and other capital by provincial and municipal governments may have serious long-term consequences. We suggest that in formulating policies

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for changes or reforms in the techniques and policies of monetary control your Commission should bear in mind the following considerations:

(a) The likely contribution of the various sectors of the economy to strong inflationary or deflationary measures.

(b) The state and effectiveness with which the various sectors respond to changes in credit policy. Special consideration should be given to the speed and effectiveness with which expenditures in the various sectors are able to recover when a policy of tight money is relaxed.

(c) The need in pursuing policies of stabilization of prices, employment and incomes to avoid discouraging our unduly affecting the long-term prospects of those sectors of the economy which constitute the core and basis of any policy of growth, specifically of the provincial and municipal governments.

In view of the significance of the volume and nature of provincial and municipal expenditures and of the special credit problems which monetary and exchange rate policies present for these governments, we recommend that provision be made for provincial government representation on the Board of Directors of the Bank of Canada.

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The Government of Ontario is particularly concerned with the problems of financing of small

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business in Canada. We are convinced that the importance of small business to the continued economic growth and social development of Canada has been all too often neglected or misunderstood.

There are three specific matters we wish to bring to the attention of your Commission. First, the Government of Ontario feels that the provision of expert advice on economic, financial and business matters would make an important contribution to the solution of financial problems of many small firms. We have already taken steps to provide such advice through the establishment of a division within the Department of Economics and Development of the Government of Ontario. Second, we feel that the problem of supplying small business with an adequate supply of long-term equity capital should be handled more forthrightly than it is at present. In particular, we feel that it would help if the Industrial Development Bank's purposes were spelled out clearly in the appropriate legislation. In our view, the Industrial Development Bank has not fulfilled the function of a development bank. The Government of Ontario has this issue under careful study and we are considering the establishment of a provincial fund which would supplement existing financial institutions in the field of industrial development and serve the purpose of economic decentralization. Finally, the Government of Ontario feels that there would be a great deal of merit in introducing policies and techniques for the selective control of credit so that small businesses could be

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given special consideration in periods of tight money. We have also considered carefully the purposes and consequences of the ceiling of interest rates charged by banks and we recommend that it be raised.

V

We have carefully studied the problems associated with consumer credit in Canada today. In our view, your Commission should urge that it be made compulsory for all institutions extending consumer credit to declare, on a comparable basis, the effective rate or range of rates which they charge in each particular transaction. It may not matter particularly if the consumer does not know the exact rate of interest he is paying but it would help him a great deal if he were enabled to compare and decide where he could get credit most cheaply. We also recommend that your Commission examine closely the legislation covering small loans companies.

VI

We cannot help emphasizing the importance which this Government places on foreign trade as an integral part of any program to achieve a satisfactory rate of economic growth in Canada. We should like to stress the role of finance in any national effort to maintain and expand our position as a great trading nation. Trade we must, and the effectiveness and expediency with which our financial system can support our efforts to export must be an important yardstick

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by which we shall measure its adequacy today, tomorrow and for a long time to come.

We draw your Commission's attention to the changing credit requirements for financing international trade. We note that there has been an increasing tendency for commercial loans to be tied to materials, equipment, engineering and other services and consumer goods, and that export credit often tends to be of long-term duration, reaching 15 to 20 years or more. We also note that export credit has become generally more risky. Hence, we are sceptical about the adequacy of traditional institutions and methods of financing foreign trade. We hope that your Commission will study ways in which private credit institutions may pool resources, lengthen terms of credit and provide for the expansion of credit to communist and other governments. You may wish to consider various inducements that the Canadian Government might offer in order to promote the new types of export credit required. The Governments of other countries are becoming increasingly aggressive in terms of export credit and export credit guarantees. It is not enough for this country to assume that its exporters enjoy just about as good terms of export credit and insurance as their competitors in other countries. The question is how we can give the Canadian exporter <u>better</u> terms and help him in capturing new markets.

The Government of Ontario wishes to draw the attention of your Commission to another avenue of promoting Canadian employment and economic growth.

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We are impressed by the very considerable possibilities which exist in this country for producing a great variety of manufactured and semi-manufactured products which are now being imported. We believe that special arrangements for credit and guaranteeing facilities serving this particular purpose would be helpful.

With respect to short-term changes in monetary policy, the Government of this Province wishes to draw your attention to the need for selective control of credit with regard to financing exports. In view of the new role assumed by export credit, the availability of credit may often be a more important consideration in foreign markets than the decline in export prices which a tightening of overall credit might bring about. In this particular field then, an indiscriminate policy of tight money may make matters worse rather than better, and in addition lead to the loss of hard-won export markets.

VII

In the field of foreign investment, the Ontario Government believes that we shall need a substantial volume of foreign capital if we are to accelerate the pace of our economic expansion. We also believe that Canada can be as attractive to foreign capital as any other country in the world. We would be missing a great opportunity if we failed to exploit to the fullest possible extent the willingness of other nations to invest in Canada's future. It would be to our advantage if some of the heavier

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requirements for future investment in human and social capital could be met partly from abroad. Your Commission could perhaps perform no greater service than to explain the role of foreign investment in Canada, in the past, present and future. It has been the subject of much misunderstanding.

We recommend that the Government of Canada in consultation with the provincial governments develop, announce and explain a clear-cut policy towards foreign investment. In particular, we advocate the removal of the present withholding tax levied on provincial and municipal bonds held abroad. We are of course aware of the need that over short-term periods it may be desirable to discourage the inflow of foreign capital. Since vital interests of provincial and municipal governments might be affected, we recommend the establishment of machinery for close consultation on these matters between Federal and Provincial Governments.

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PART I

THE GOALS OF OUR ECONOMIC AND FINANCIAL SYSTEM

1. The overall function of our financial and monetary system and policies, or for that matter of our whole economic system, is to serve certain fundamental purposes or goals. Accordingly, the extent to which the financial system succeeds in serving these ends must be the criterion of the adequacy and efficiency of that system and its various component parts. We must set out our objectives and emphasize what we believe to be the overriding consideration by which our financial system and monetary policy will be judged.

2. At the outset it should be made clear that we are not concerned here with purely technical deficiencies or shortcomings in our financial institutions and monetary policies. Our concern is with the broader problem of national and provincial economic and social goals, and with the relationship of the financial institutions and monetary policies to these goals.

3. The Government of Ontario believes that our primary goal should be the achievement of a satisfactory rate of economic growth in this country.

4. We are fully cognizant that a high rate of economic growth is often accompanied by dislocations in our social and economic framework. Human beings are adaptable and can adjust to social and economic changes. But the possibility of adjustment becomes smaller, and the difficulties or pains of adjustment

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[illegible] SYSTEM

1. The overall function of our financial and monetary system and policies, or for that matter of our whole economic system, is to serve certain fundamental purposes or goals. Accordingly, the extent to which the financial system succeeds in serving these ends must be the criterion of the adequacy and efficiency of that system and its various component parts. We must set out our objectives and emphasize what we believe to be the overriding [illegible] by which our financial system and monetary policy will be judged.

2. At the outset it should be made clear that we are not concerned here with purely technical deficiencies or shortcomings in our financial institutions and monetary policies. Our concern is with the broader problem of national and provincial economic and social goals, and with the relationship of the financial institutions and monetary policies to these goals.

3. The Government of Ontario believes that our primary goal should be the achievement of a satisfactory rate of economic growth in this country.

4. We are fully cognizant that a high rate of economic growth is often accompanied by dislocations in our social and economic framework. Human beings are adaptable and can adjust to social and economic changes. But the possibility of adjustment becomes smaller, and the difficulties or pains of adjustment

greater, the greater is the rate of change. Economic growth, therefore, is not the only goal. Among the other objectives of our economic system must be a reasonable short-term stability in economic affairs, especially in the levels of employment and income.

5. In recent years, unemployment has become the focus of national attention. We need not go into the details of the economic, political and social disadvantages and dangers attached to unemployment. The loss of labour time that can never be recovered, the demoralizing effects of unemployment and the inequitable distribution of income that it usually entails are well understood. Governments have assumed a greater degree of responsibility for curing this ailment and have accepted the goal of full employment as one of their major economic objectives. It would be absurd to expect that monetary policy alone - or even with the help of appropriate fiscal policy - could cure all kinds of unemployment under all circumstances. On the other hand, our financial and monetary system and policies can and do affect the levels of employment and unemployment in Canada.

6. A fair stability of prices is another goal on which there seems to be general agreement. Strictly speaking, price stability is not a goal in itself: prices and price changes are the mechanism by which we allocate our economic resources and decide what to produce, how to produce and for whom to produce. However, a pronounced instability of prices can have a number of very detrimental effects on our economic

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and financial system and social and political fabric. Accordingly, a reasonable stability of prices is usually mentioned as a separate goal of economic policy.

7. Of course, stability of employment, incomes and prices does not mean that the economy should be inflexible. A changing economy - one in which the volume and pattern of resources on the one hand, and the requirements of various goods and services on the other, are changing continuously and substantially - calls for frequent and far-reaching adjustments. Flexibility in our economic system will help in dealing with the problems of adaptation to economic, as well as social and political changes, at home and abroad. It will help to minimize dislocations and unemployment by facilitating transfers of factors of production between industries, occupations and localities, and, in the long run, it will facilitate economic growth. A financial system and monetary policy conducive to a flexible economy will be invaluable to this country in a rapidly changing world economy, especially in a period of accelerated technological change.

8. In the minds of large sections of our population equality of opportunity and an equitable distribution of the national product are just as important as the size of the total product. It has been claimed that the present structure and manner of operation of certain sectors of the financial system involve an unfair treatment of classes of our population which have modest incomes and which are ignorant of financial

matters. There have been frequent references to exhorbitant charges on consumer credit. Again, it has been charged that, at times, the policies of the central and chartered banks, combined with the ceiling on interest rates, have tightened credit in a manner which discriminates against small businesses, and hence, over the long run, tends to damage their vitality and to threaten their viability. There is no doubt that our financial system and policies are key determinants of the distribution of opportunity and income in our economy.

9. Any listing of national objectives would be incomplete without consideration of Canada's balance of payments position. Through trade and financial intercourse we manage to increase our incomes and to secure additional resources for the development of our economy. The efficiency with which our financial system is able to finance our foreign trade and other related sectors of our economy, and to facilitate the international movement of capital, technology and population in our best interest, is another criterion by which our financial system must be judged. It is difficult to overemphasize the importance of appropriate credit, fiscal and exchange rate policies for the balance of trade and payments of a country like Canada.

10. In addition to material ends, our economic and financial system is expected to serve goals which might be termed political and ethical or humanitarian. These include Canada's independence

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and security, and the discharge of our moral duty to help our fellow human beings in the less well-to-do countries of the world. It is obvious that these purposes can be served best by a strong and growing economy.

11. These, then, are the fundamental goals that our economic and financial system is called upon to serve: a satisfactory rate of economic growth; full employment; stability of incomes and an equitable distribution of the national product. The other purposes mentioned, namely stability of prices, economic flexibility, and well-balanced trade and payments relations with the rest of the world, are important intermediate goals or constraints in the achievement of the basic goals.

12. Quite often, given policies or measures tend to serve more than one goal. Thus, a growing economy provides a good deal of flexibility and is helpful to the maintenance of a high level of employment, so that policies or institutions conducive to economic growth help also towards the achievement of full employment. On the other hand, there may be cases in which the pursuance of one goal may be difficult or impossible without compromising with respect to another. For instance, at times rapid economic growth can only be achieved at the expense of inflation and instability of incomes; and domestic economic stability and expansion may clash with stability of the exchange rate.

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desirable goals are - on this matter there seems to be general agreement. The question is rather what relative significance should be attached to each goal. And this is a thorny problem, involving political, ethical and economic considerations.

14. Different people assign different significance to the various goals. While the young may stress economic expansion, and labour may emphasize full employment, the old are interested strongly in the stability of prices. Furthermore, the importance of the various goals changes with time and circumstances. An economy which has been stagnant for some time may be prepared to accept price increases if these are indispensable to growth whereas an economy which has been advancing at satisfactory rates may devote its major effort to fight inflation. Since the end of the Second World War, we have witnessed changes in the emphasis placed on these various goals.

15. It is clearly difficult to expect universal agreement on the desirable combination of rate of economic growth and maximum rates of unemployment and increase in prices. It is equally clear, however, that uncertainty or disagreement in responsible circles about the mix of goals to be pursued is not conducive to the formulation of appropriate policies.

16. It would seem clearly desirable from time to time to have a public announcement from responsible circles of the particular mix of goals at which the Canadian economy is aiming. Such an announcement could not be expected to settle the issue of what the

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desirable mix of goals should be. On the other hand, the suggested announcement would invite discussion about the feasibility and desirability of that particular mix, the factors that should be taken into consideration in determining it at various times and under various circumstances, and the effects of pushing one goal on the achievement of others. For instance, a specific increase in the rate of growth of national income might entail an additional increase in prices of a certain amount.

17. Such an announcement would serve as a beacon of the direction in which public policy is leading the economy; and public reaction to this indication may be such as to make achievement of the mix easier. Finally, such a policy would compel those who would argue about economic and financial policies and techniques to start from clear assumptions as to the purposes or goals involved - more specifically, to indicate whether it is the mix of goals about which they disagree, or the techniques and policies by which an agreed-upon mix can be achieved. This type of discussion would throw more light on the problems involved than discussions in the past, even though it might produce just as much heat. Disagreement on economic goals and techniques is perfectly consistent with our democratic system of government.

18. The Government of Ontario considers that the overriding goal of economic and financial organization and policy should be economic growth. To achieve this end, all other goals should be subordinate. While we

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recognize the importance of all these goals, we are convinced that their achievement will be made much easier if we can maintain a satisfactory rate of economic growth in the Province and in Canada as a whole. The economy of this Province depends very considerably on manufacturing, mining, agriculture and exports, and is therefore exposed to instability of employment, prices and incomes. Consequently, we place great value on a financial system and monetary and fiscal policies capable of mitigating such instability. Nevertheless, we are convinced that economic growth should have first priority. And, therefore, our financial system and monetary and fiscal policies should be so ordered as to gain this end. Economic growth has served, and will continue to serve as the guide-post of the economic policies of the Government of this Province.

19. We conclude by urging your Commission to use the promotion of a satisfactory rate and pattern of economic growth as the chief test of the structure, functioning and policies of our financial and monetary system. We recommend further that this goal should be explicitly stated and specifically stressed in the Preamble to the Bank of Canada Act.

20. In the various countries the relations between the Government and the Central Bank are regulated by tradition or statute. Recent experience suggests that in this country there have been considerable uncertainties and changing views as to the role of the Bank of Canada. We consider it imperative that

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it be clarified by statute that the decision on the combination of goals of monetary and related policies rests exclusively upon the elected representatives of the people of Canada.

21. The relation between the Bank of Canada and the Government of Canada must be clarified also with respect to the policies used in pursuing the chosen goals. Monetary, budgetary and debt management policies are closely interrelated as to the techniques employed and their effects. In view of the economic, social and political implications of these policies, particularly with reference to economic growth and employment, it would be unwise to leave any doubt as to the ultimate responsibility of the Government of Canada in these matters.

THE NEED FOR MORE RESEARCH AND INFORMATION

22. There has been a growing concern in the Province of Ontario over the need in Canada for an institution of economic and business research. In the United States, the National Bureau of Economic Research - a private non-profit organization of national and international reputation has for many years been studying problems of the American economy. Its work has been supplemented by economic and business studies undertaken at a number of other highly efficient institutes of economic research. Similar institutes have been established in the last three or four decades in practically every advanced country, for instance, in Great Britain, Germany, Sweden and the Netherlands. Going further afield, Western aid has helped to establish similar research institutes in a number of underdeveloped countries, for example, in India and Pakistan.

23. In Canada, on the other hand, there is no such permanent, independent, national institute for economic research - an institute which might have undertaken a study of Canadian economic growth, the banking and financial system or the problems facing small business. This country has relied inordinately on the less efficient and more expensive procedure of appointing <u>ad hoc</u> Royal Commissions to deal with some of its broadest and most fundamental economic problems. This is not to imply that Royal Commissions have not been of value. We are suggesting that experience and

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wisdom, drafted hurriedly and intermittently, can be valuable complements of, but certainly no substitutes for, systematic and painstaking research requiring continuity, considerable time and carefully selected personnel.

24. Within its own jurisdiction, the Province of Ontario has established the Ontario Economic Council which has been given broad terms of reference and empowered to conduct and commission economic studies and to make recommendations to the Government. Within the Department of Economics and Development of Ontario, continuing research is being undertaken on a wide variety of short and long term economic problems affecting economic development in the Province and in the country as a whole. In this way we have made an initial attack in this Province in meeting the problem of research into business and economic matters.

25. On the other hand, there are many broader issues, concerning the whole Canadian economy, which call for systematic study. Your Commission could perhaps make a great contribution to the improvement of our financial and banking system, and, more generally, to Canada's economic development and stability if it strongly urged the establishment of a National Institute for Economic Research. The Government of Ontario is prepared to cooperate in a private or public effort aimed at creating such an organization.

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Commission's terms of reference. To dispel any doubts, your Commission should make it clear that, if finance is important for economic growth and stability, so is knowledge based on methodical collection and analysis of information. Only such knowledge can provide the indispensible background for constructive financial and monetary reforms and policies. This country is neither so small nor so poor that it has to base the discussion of a number of its economic problems on information and analysis relating to the United States, on the assumption that our problems are simply a miniature replica of those south of the border. It would certainly be a great pity, if a number of years from now another Royal Commission on Banking and Finance were faced with the same lack of useful background information that you have had to cope with.

27. We are also concerned with the necessity for knowledge and adequate channels of communication and information at other levels. Specifically, small economic units including small firms in manufacturing, mining, agriculture and the services, as well as the Canadian consumer, are very often unaware of even the approximate scope and nature of their financial problems and requirements. Another fact repeatedly brought to our attention during the preparation of this Submission is that too often the individual or small entrepreneur is ignorant of the sources and methods of finance open to him and of the size and consequences of the financial burdens which he may unwittingly take on. These are serious flaws in our

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system of free enterprise.

28. We are convinced that many of the problems facing businesses of small or medium size in manufacturing, agriculture, mining, forestry, transportation and the services originate in lack of information and financial and technical knowledge, rather than of capital or other resources. Improvements in the channels and effectiveness of business communication in the broadest sense is required more urgently than any change in the number and size of financial institutions and their methods of finance. Such improvements would make a strong contribution to successful financial planning, would minimize the barriers which compartmentalize our economy and would further the goals of economic growth and of a fair and equitable distribution of income among the various economic units. We ask your Commission to emphasize the problem and to give full consideration to ways by which improvements may be achieved.

THE FINANCING OF PROVINCIAL AND MUNICIPAL RESPONSIBILITIES

29. In this Part we discuss the importance of investment in human capital to economic growth, the role of the provinces and the municipalities in supplying this capital, and the problems which these bodies have in financing their responsibilities. We place particular emphasis on the relationship between responsibilities of the provinces and the municipalities and the volume and nature of their revenue resources. Attention is also given to the effect of credit restrictions on the financing of their activities.

A - The Importance of Human Capital

30. There should be little doubt about the enormous contribution which a well-organized and adequately progressing system of education and training can make to the achievement of certain important economic and social goals. Nothing can help more towards a reasonable equality of opportunity and a fair share of income for the people of this country than such a system of education and training. It would be absurd through taxation and other policies to attempt to correct the consequences of inequality of opportunity by redistributing income, while neglecting to tackle the cause of much of this inequality.

31. The achievement and maintenance of full employment has been listed as another important goal of our economic and financial system. But in a world

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of rapidly changing technology, communications and transportation, full employment can be obtained only in a truly flexible economy. There are few factors that can increase the flexibility of our economy more than the education and training of our labour force. Without the requisite skills in our labour force we will continue to be plagued with structural unemployment. The Province of Ontario, therefore, places great emphasis on the education of our young people and the retraining of our workers to meet the changing needs of our economy.

32. We turn to what we consider as the major goal of our economic and financial system, namely economic growth. Quite often economic growth is related, indeed, "ascribed", to the formation of physical capital: to expenditures on new structures, machinery, equipment, and inventories. By contrast, not enough emphasis has been put on expenditures designed to improve the education, training, strength, stamina, mental health, vigour and vitality of our people. To some, expenditures on these items represent a waste of resources which might have been invested in physical assets.

33. It is only in recent years that there has been any appreciation - and any attempt at measurement - of the tremendous contribution to increases in productivity and economic growth of investments in "intangible assets" or "human capital." These expenditures are gaining more and more recognition

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as a source, as well as a product, of increases in incomes and economic expansion.

34. Studies undertaken in the United States indicate that only about one-half of the increase in gross national product over the last sixty years can be attributed to the increase in input of manhours and physical capital; and that a large part of the increase in national product must be explained by the increase in intangible assets and improvements in the efficiency of labour, due to investment in health, education, training and scientific and technological advance. These studies suggest also that the return on human capital in the form of investment in education has been at least equal, and probably has exceeded considerably, the return on investment in physical capital.

35. These findings about the relation of investment in human capital to economic development have been termed astounding. Even more astounding than these results has been the slowness of Canadians to recognize the great productive significance of these expenditures. Your Commission will be doing a great service to this country if it emphasizes and vividly illustrates the importance of investment in human capital.

B - Government Expenditures on Human and Social Capital

36. Public expenditures on health, welfare and education rank among the chief responsibilities of

the provincial and municipal governments of Canada. One may well describe these Governments as the public agencies which specialize in the formation of Canada's human capital. Seen in this light, the importance of provincial and municipal finance can hardly be over-emphasized.

37. In addition to its emphasis on human capital, the Government of this Province places great importance on its responsibilities for the provision of social overhead capital, which is indispensable for the growth and expansion of private business. The Province and its municipalities, in their role as agencies for the provision of physical assets such as roads, sewers, energy sources, etc., have been aptly described as the right arm of development. It is hardly necessary for the Government of Ontario to describe its activities in these fields. They are too well known and no brief reference to them could do justice to the magnitude of our achievements. Our Government has every reason for being proud of its record in this field. We are more concerned, however, with the provision of adequate social overhead capital in the future than with any past achievements.

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secondly, because the public share in the expenditure on these services is likely to grow.

39. We cannot help stressing that Canadian economic growth will depend in the future on a very substantial increase in expenditures on health and education. Our economic development tends to depend less and less on the discovery and exploitation of new natural resources, and more and more on the better use of our known resources, which is brought about through technical improvements, the development of skills and automation. In turn, these developments depend heavily on investment in health, education, advances in technology and other forms of intangible capital. Economic development will not only depend on, but will also call for, a substantial increase in the relative importance of outlays on education and health.

40. The assumption by government of increasing responsibility for investment in human capital is due largely to the expanding recognition of the value of human resources as a national asset, as well as to the peculiar features of investment in human capital. This increasing government responsibility is a natural response to the increasing demand for equality of economic opportunity and a fair share in the national income. We are convinced that the role of education in preparing our young people for the future has never before been more vital to our economic and social progress, indeed, even to our national survival, than it is today.

secondly, because the public share in the expenditure on these services is likely to grow.

39. We cannot help stressing that Canadian economic growth will depend in the future on a very substantial increase in expenditures on health and education. Our economic development tends to depend less and less on the discovery and exploitation of new natural resources, and more and more on the better use of our known resources, which is brought about through technical improvements, the development of skills and automation. In turn, those developments depend heavily on investment in health, education, advances in technology and other forms of intangible capital. Economic development will not only depend on, but will also call for, a substantial increase in the relative importance of outlays on education and health.

40. The assumption by government of increasing responsibility for investment in human capital is due largely to the expanding recognition of the value of human resources as a national asset, as well as to the peculiar features of investment in human capital. This increasing government responsibility is a natural response to the increasing demand for equality of economic opportunity and a fair share in the national income. We are convinced that the role of education in preparing our young people for the future has never before been more vital to our economic and social progress, indeed, even to our national survival, than it is today.

41. We can illustrate this point by a brief reference to the Ontario situation. In September 1961 enrolment in elementary and secondary schools in this Province totalled 1,462,000 pupils. It is estimated that by 1970 total enrolment in these schools will amount to 1,781,000 pupils. To accommodate this increase in enrolment, provincial grants to school boards which amounted to $181 million last year will more than double, reaching a total of $400 million by 1970. These figures do not take into account the cost of operating teachers' colleges and other special services provided by the Province nor do they include our grants to universities, which will rise proportionately. A similar story can be told in the total cost of operating the Ontario Hospital Services Commission. In 1962 the direct cost to the Ontario Government was in the neighbourhood of $52 million. In three years' time the cost to the Provincial Government alone is expected to be in excess of $100 million. These figures give some indication of the expanding total financial burden facing the Province in the coming years.

C - The Need for More Adequate and Stable Revenue Sources

42. The Government of this Province is gravely concerned about the strain that the anticipated expenditures on education and health will exercise on the finances of the Province and its municipalities. We recognize the necessity of providing both for this increased investment in human capital and for

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the growth of physical assets which will be required by an expanding economy,but, unless the Province and the municipalities are endowed with more adequate tax revenues, and unless the financial system and monetary policy are adapted to meet the growing needs of the Province and the municipalities we may be unable to fully meet our responsibility in these vital fields of investment. The probable repercussions on employment and economic growth are obvious.

43. Total expenditures of provincial and municipal governments have increased in recent years much faster than Canada's gross national expenditure or expenditure of the Federal Government. Between 1949 and 1961, the gross national expenditure in current dollars increased by 120 per cent, the total budgetary expenditure of the Federal Government rose by 162 per cent and the total budgetary expenditure of the Government of Ontario rose 218 per cent. The municipalities increased their expenditures at a rate corresponding to provincial expenditures.

44. In order to match these quite different rates of expansion and expenditure the taxes of the lower levels of government had to expand more than the Federal Government revenues. We are concerned that this pressure may have led to over-expansion of certain taxes while others are under-utilized. For example, between 1949 and 1960 Federal Government revenue from the personal income tax more than doubled, municipal revenue from the real property tax

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more than tripled.

45. The real property tax would have had to increase more than three times were it not for the very substantial increase in provincial aid to the municipalities: for instance, Ontario's 1962-63 budget provides for aid to the Province's municipalities, school boards and other local agencies of about $425 million, an amount equal to no less than 45 per cent of the Province's current revenues. This means that the burden of financing a large part of municipal expenditures has been shifted to provincial taxes, a fact which raises the same type of question we are discussing, namely, whether taxes under provincial jurisdiction have not been forced into overexpansion.

46. We are deeply concerned with the continuing autonomy and independence of the municipalities in this Province. The Government of Ontario has at all times pursued policies designed to strengthen the autonomy of the municipalities by giving them financial support rather than by taking over responsibilities that are historically and traditionally municipal functions. While some have argued that the Province should take over full responsibility for education, we believe that it is essential for the maintenance of viable local government that the municipalities play a fundamental part in the provision of education. It is our contention that active municipal governments are essential to our democratic system.

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47. To deal with the question of tax revenues and responsibilities the Prime Minister of Ontario has announced that Ontario will appoint a Commission to undertake a full-scale investigation into the structure of provincial and municipal taxation. He has also repeatedly urged an early examination of the issue of taxation and allocation of tax revenue between the various levels of government through a Federal Royal Commission. Although we welcome the appointment of a Royal Commission on Taxation, it is our view that the terms of reference of this Commission are not broad enough.

48. It is clear that the problems of provincial and municipal finance which we have outlined call for the most careful attention of your Commission. Questions of availability and cost of credit to provincial and municipal governments are closely related to the nature, volume flexibility and other features of their tax revenues. In view of the importance of government revenues and expenditures, at all levels, in present-day Canada, reforms of credit institutions,methods and policies must go hand in hand with a rational reorganization of our fiscal structure.

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49. Investment in material capital and expenditures on the creation of human capital give rise to different problems. The call for, and flow of business investment in structures, equipment and inventories is subject to extensive fluctuations over fairly short

periods. On the other hand, the very different nature of investment in human capital and in such physical assets as highways, water systems, and sewage disposal plants makes similar changes in investment policies over short periods totally inappropriate. While the decisions to undertake business investment depend largely on the prospects of changes in incomes and expenditures - elements which are subject to considerable short-term fluctuations - investment in human capital and in such physical assets as government provides must vary largely with population changes and other long-term factors. For example, once a child enters the school system, the responsible governments must provide the physical facilities for him until he leaves the system. In contrast, a large proportion of Federal Government expenditure can be expanded or contracted substantially in accordance with economic needs.

50. There are often long delays intervening between the stages of realization, deliberation, decision blueprinting and execution of provincial and municipal expenditures. In some cases the approval of the taxpayers, or of a provincial administrative authority, such as the Ontario Municipal Board, must be obtained. This means that if we allow investment in human capital to be affected adversely by such disturbances as a decline in the rate of growth in revenues, a tight money policy, or inflation, the effective recovery of these types of investment

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may be difficult and slow. Therefore, such disturbances may have serious long-run consequences: investment in human capital, and other social overhead facilities, undertaken by provincial and municipal governments may be disproportionately low.

51. Since expenditures on health, education, and other social capital must grow at a fairly steady rate, the provinces and the municipalities must be able to rely on steadily growing revenues and a fairly stable supply of outside finance. No doubt, the governments responsible for these expenditures should be able to do some shifting of financial resources between their various financial requirements as the need arises. However, it is often very difficult for provincial and municipal governments to adjust their expenditures in this fashion because so much of their expenditures are inflexible and growing steadily: in 1960 about 56 per cent of the current expenditure of all provincial governments and 40 per cent of municipal current expenditure consisted of outlays on education, health and public welfare (excluding relief). It is obvious that a short-period decline in the rate of growth of total financial resources of these governments might require very drastic - well-nigh impossible - restrictions in their other expenditures if these governments are to provide steadily growing outlays on social and human capital. It might be noted also that, unlike large business firms, provincial and municipal governments do not have financial assets or other

resources to draw on when the need arises. We repeat that they must be able to depend on a steadily growing source of revenue and supply of loan capital.

52. The stable growth of the revenues of provincial and municipal governments depends heavily on circumstances beyond their control: on changes in business activity, prices and incomes, which affect for instance the return of provincial taxes on corporation profits and the real value of the various tax revenues. It is therefore necessary for us to emphasize the importance we attach to fiscal and monetary policies aimed at evening out fluctuations in employment, incomes and prices. In addition, we might suggest that your Commission should examine on the one hand the variability of the various public expenditures and its consequences, as they relate in the short run for instance to economic stability, and in the long run to economic development; and on the other hand it should consider the cyclical variability of the various tax revenues. In recommending, then, adjustments in the distribution of tax revenue between the various levels of government you might take into consideration, among other factors, first the need of provincial and municipal governments for a cyclically stable and steadily growing tax revenue, and secondly, the desirability of leaving to the Federal Government those types of taxes whose revenue normally changes cyclically, and which are subject to easy manipulation in counter-cyclical policies.

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53. We also wish to draw to your attention the great increase in the volume of provincial finances and the role which they now play in the Canadian economy. We recommend that machinery be devised for regular consultation between the Federal and Provincial Governments on the state of the Canadian economy and the possibility of concerted Federal-Provincial anti-cyclical policies.

D - The Effect of Monetary Policy on Investment in Human Capital

54. When revenues are insufficient provincial and municipal governments try to supplement their resources through borrowing. Unfortunately, changes in monetary and exchange rate policies have often caused considerable difficulties to these governments. Most of the investments in social capital, material and human, undertaken by these governments are of a long-term nature and cannot be turned off and on. Accordingly, these governments require loans amortizable over long periods. On such loans interest payments constitute a large part of the debt service, and the yearly amortization a relatively small one. Consequently, changes towards a policy of tight credit affect the financing of provincial and municipal governments and their investment projects considerably more than they affect the financing of business investment. On the other hand, on account of business uncertainty, technical obsolescence and other factors a large part of industrial investment is amortized over relatively short periods, and the level of

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interest rates is not as important a consideration. Another reason why changes in the availability and cost of funds tend to have a greater influence on the capital expenditures of provincial and municipal governments than of private business is that the proportion of capital expenditures which is financed by borrowing is usually larger in the case of these governments than in the case of most private businesses.

55. This is not place to consider in any detail the merits and disadvantages of our system and techniques of credit control, or the pros and cons of selective control of credit. There is hardly any type of monetary policy that does not, in effect, discriminate against some sector of the economy. It is necessary, however, to convey our view that tightening of credit, in the manner practised in Canada, has often had an unduly limited effect on those sectors of the economy, investment in inventories, purchases of consumer durables or land speculation etc., which might have been responsible for inflationary pressures. Changes in interest rates, may not affect decisions in these areas because interest costs respond too slowly to changes in open market rates of interest, changes in interest rates are a secondary consideration in decisions to borrow, or, because informal rationing of credit may not have been very effective. On the other hand, credit tightening has affected seriously sectors of the economy which were not among those responsible for sudden inflationary pressures, such

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as government expenditure programs which are vitally important from the point of view of the desirable rate and pattern of the economic and social development of Canada. For the reasons indicated in the previous paragraph provincial and municipal governments have been hit hard by policies of credit restriction; so has small business, as indicated in more detail later in our submission.

56. The foregoing discussion has suggested that short-term changes in the supply of resources for financing investment in human, and other capital by provincial and municipal governments may have serious consequences. First, such changes are inconsistent with the requirements of investment in human and social capital, which by their very nature call for a smoothly rising flow of resources. Second, these expenditures tend to recover slowly and with difficulty, once they are reduced. We suggest that in formulating proposals for changes or reforms in the techniques and policies of monetary control your Commission should bear in mind the following considerations among others:

(a) the likely contribution of the various sectors of the economy to sudden inflationary or deflationary pressures;

(b) the speed and effectiveness with which the various sectors respond to changes in credit policy; special consideration should be given to the speed and effectiveness with which

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expenditures in the various sectors are able to recover when a policy of tight money is relaxed;

(c) the need, in pursuing policies of stabiliation of prices, employment and incomes, to avoid discouraging or otherwise unduly affecting the long-term prospects and development of those sectors of the economy which constitute the core and basis of any policy of growth.

As we read the record, our long-term economic and social development has not infrequently been sacrificed to ill-conceived and ill-time stabilization measures. In view of the fundamental national importance of investment in social capital and of provincial and municipal finance, we hope that, in considering these matters and recommending goals and techniques of monetary policy, your Commission will see fit to single out and emphasize the peculiarities of provincial and municipal finance, and to advocate making the financial requirements of these governments an important guide post of monetary, exchange rate and other economic policies. Adequate consideration of the foregoing points may well call for policies and techniques of selective control of credit.

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provincial and municipal governments, and in favour of public expenditures under federal jurisdiction. To say the least, the views of the Federal Government influence the Bank of Canada. In addition, the latter acts as the financial agent and debt manager for the Federal Government. It follows that the requirements and interests of the Federal Government are taken fully into consideration by the Bank when deciding on the timing, extent and pattern of changes in monetary policy. The needs of the lower levels of government, in our opinion, do not receive analogous consideration. In view of the significance of the volume and nature of provincial and municipal expenditures, and of the special problems that credit to these governments presents for monetary and exchange rate policies, we recommend that provision be made for the provincial governments to be represented on the Board of Directors of the Bank of Canada through a provincial nominee.

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PART IV

THE FINANCING OF SMALL BUSINESS

58. We turn now to problems of financing the private business sector. We shall concentrate on those problems relating to small business. It appears that larger businesses in the various areas of the private sector are, in the main, adequately serviced by existing financial institutions. During the preparation of material for this Submission we became convinced that this was not the case with smaller businesses - including firms and individuals engaged in manufacturing, mining, agriculture and the services.

A - The Importance of Small Business

59. Most people would be surprised to learn of the number and extent of small businesses in this country. In Ontario only 50 per cent of our labour force finds employment in firms of fiteen or more employees. The other 50 per cent work in smaller firms or are self-employed. Of the more than 13,000 manufacturing establishments in Ontario more than 8,000 employ less than 15 workers. Regardless of which definition of small business is used (i.e. value of assets, gross profits, number of employees, gross sales, etc.), approximately 90 per cent of all businesses in Canada are small.

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whole economy expands the relative importance of the various sectors of the economy changes. Development, therefore, hinges on the successive establishment and rapid growth in each new period of new firms and industries. New businesses, usually associated with different localities and "new" men and families, succeed others whose rate of growth has slackened, in supporting Canada's rate of economic development. The new firms in the longer run carry the torch of growth; and while new firms need not be small,small firms account for a very important part of new businesses.

61. In discussions relating to economic growth there has been an unfortunate tendency to overrate the role of organized ressarch by large corporations. It cannot be stated too emphatically that both the development of new ideas (new processes, new products and new markets) and their application have depended and will probably continue to depend to a large extent on the ingenuity and drive of the individual business owner. If the motives that energize his action are stultified through the lack of appropriate finance, or in any other way, his ingenuity and drive may be totally lost to the economy. The significance for Canada's economic growth of the "little man with an idea" cannot be overstressed.

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expanding small businesses. Longer term credit serves to bring much closer the date of possible investment. People who would not consider saving for too distant a goal, will readily save in order to secure a "down-payment." Moreover, people are prepared to take considerable risks when they invest in their own small business and therefore the supply of risk capital is enhanced.

63. In many cases small towns and villages can support only small local firms. Accordingly, the decentralization of our economy is closely related to the survival and progress of small business. Canada would be very fortunate if she were spared some of the economic and social costs of overcongestion and overindustrialization of a few metropolitan centres at the expense of the rest of the country.

64. In larger urban areas there are many indispensable industries and services which are not suited to big business organization and can be performed adequately only by small business. On the basis of our present knowledge of techniques and management this seems to be true about many personal services, a variety of tourist and entertainment services and the professions. Finally, small businesses often constitute a valuable complement to big businesses, supplementing big businesses "at the edges."

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and political advantages for this country. Small business helps to endow life with that variety which is associated with the production of goods and services tailored to individual tastes. Above all, the survival and progress of small private businesses provides one of the strongest contributions to individualism, non-conformity, personal freedom and our system of free enterprise. We cannot imagine a better defence of the social fabric and pattern of life which we so highly treasure than the encouragement of individual ingenuity and drive.

B - <u>The Problems Facing Small Businesses</u>

66. It is our understanding that the staff of the Royal Commission on Banking and Finance is undertaking a study of the problems of financing small business. We are sure that their findings will prove to be extremely useful in providing knowledge on the sources, methods, and policies of finance of such firms. At the present time, published material on these matters relating to the Canadian situation is inadequate. That small business has special problems is evidenced by the fact that the Federal Government has passed legislation such as the Small Businesses Loans Act, the Farm Credit Act and the Industrial Development Bank Act. In the private sector new institutions such as RoyNat have moved into this field.

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B - The Problems Facing Small Businesses

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67. In our view, special consideration of the problem of medium and long-term finance of small business is required. With the introduction of

progressive income taxes it has become increasingly difficult to finance small concerns through self-finance or by raising capital privately. In recent decades advertising campaigns and "education" have turned investors to life insurance, blue chip stocks, government bonds and the like. Saving has increasingly been institutionalized in Canada. The chartered banks are primarily short-term lenders and are therefore not a significant source of medium or long-term capital for small firms.

68. The financial foundation of small firms is normally less secure than large firms. Their production tends to be less diversified and their earnings generally are less stable. Because they are often new in the field they are usually short of expertise and lack experience. Furthermore, the management of unincorporated firms is tied to particular individuals and their heirs. Hence the continuity of suitable leadership is quite uncertain. All these factors give rise to doubts in the lender's mind about the ability of a small firm to meet its financial obligations in the future and therefore weakens its prospects of getting finance today.

69. Because of its newness or its smallness, the smaller firm may not have demonstrated its credit-worthiness. If it is a new firm it may lack even a good record of management and earnings. Under these circumstances the lender wants to be doubly sure about the prospects for recovery of funds loaned.

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59. Because of its newness or its smallness, the smaller firm may not have demonstrated its credit-worthiness. If it is a new firm it may lack even a good record of management and earnings. Under these circumstances the lender wants to be doubly sure about the prospects for recovery of funds loaned.

This calls for a more elaborate investigation which raises the cost of borrowing.

70. Finally, the small firm often lacks the knowledge required for choosing the best sources and methods of finance, and it may well lack the skill and experience required (financial, economic, managerial and legal) for assessing its credit requirements and presenting its case. Quite often, as noted in Part II of this Submission, it is this difficulty rather than any objective lack of creditworthiness that is the main problem facing small business. The lending institution has to convince itself rather than let itself be convinced about the prospective borrower's needs, the adequacy of the security offered and the prospects of repayment. For these and other reasons there seems to be a limited amount of credit available to small firms for medium and long-term finance.

71. In this situation, the Government of Ontario feels that the provision of expert advice would make an important contribution to the solution of the financial problems of many small firms. It would contribute, among other things, to a reduction in the high cost of investigation of the financial position of such firms and of public floatation of their issues. The Government of Ontario is planning to establish, within the Department of Economics and Development, a division whose function will be to give expert advice on these matters. We are

Toronto, Ontario

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convinced that such a program would go far in solving many of the problems involved in the financing of small firms.

C Medium and Long-Term Financing

72. The problem of supplying small business with an adequate volume of longer-term credit and equity capital is neither unknown, nor new. At least for the last three decades it has been clearly recognized and has begged for a solution. Since the end of the War measures have been adopted in several advanced countries to cope with the problem. However, as explained more fully later, in this country the measures taken have been patently inadequate. As we read the record, there has not been much difficulty in understanding the existence and nature of the problem which faces small business. The reason for the inadequacy of the solutions adopted lies rather in the inability of a continent dazzled by bigness, longness and tallness to recognize and appreciate sufficiently the tremendous importance of small business. Indeed, the immense contribution of small business in terms of employment, incomes, taxes and investment to our economy is neither well known nor understood.

73. In an effort to cope with the problem of longer-term finance of small business, almost two decades ago the Federal Government established the Industrial Development Bank as a subsidiary of the Bank of Canada. The declared purpose of the new

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73. In an effort to cope with the problem of longer-term finance of small business, almost two decades ago the Federal Government established the Industrial Development Bank as a subsidiary of the Bank of Canada. The declared purpose of the new

Bank was to give "particular consideration to the financing problems of small enterprises." However, even allowing for the substantial expansion of the Bank's operation since 1961 and the welcome announcement in the Federal Speech from the Throne that we can expect a further expansion of its activities this coming year, it would be difficult for it to claim that it has more than scratched the surface. On the average of seventeen years, from November 1, 1944 to September 30, 1961, it extended loans totalling less than $22 million a year. This is a paltry sum in proportion to Canada's income and capital investment: it is equal to a little over one-half of one per cent of Canada's average yearly private investment in new non-residential construction and machinery and equipment, in the period 1945-1960. Nor can the Bank claim that its credit operations were conservative initially, but picked up steam later: the corresponding percentage in the period 1956-1960 was exactly the same. While in the years 1959 and 1960 the Bank lent in the Province of Manitoba $3.96 million, the Manitoba Development Fund (a provincial development credit institution) found it necessary to lend in a little more than two years after its establishment (from December 15, 1958 to March 31, 1961) an additional $4.54 million. In short, it simply didn't meet the need in Manitoba.

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Development Bank. At the present time it is difficult to know whether the I.D.B. is designed primarily to assist small business, to promote regional development or to advance industrial development in the less wealthy provinces. While each of these activities are commendable in themselves, it would help to clear the air if the Industrial Development Bank's purposes were spelled out clearly in the appropriate legislation.

76. The problems discussed in these pages have concerned this Government for some time. In view of the character of the Industrial Development Bank - a federal institution and a subsidiary of the Bank of Canada - we cannot be sanguine about the likelihood of its adopting a much more active policy. In seven of Ontario's sister provinces the Provincial Governments, either directly or through special lending agencies or Development Funds, supply or help in the provision of medium-term or long-term finance to small business. Accordingly, the Government of Ontario has the issue of the creation of a development fund under active consideration in both theDepartment of Economics and Development and the Ontario Economic Council. The aim of an Ontario fund would be to supplement existing financial institutions in the field of industrial development and economic decentralization. As yet, a final decision on this fund has not been made.

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D Short-Term Financing

77. We now turn to another problem that seems to trouble small business. It appears that in periods of monetary restriction the short-term financing of small firms is affected more than the financing of larger ones. As indicated later, this is not - as it might seem to be - merely a problem of short-term finance; the ability of small firms to attract longer-term finance, and hence also their very prospects of existence and growth, may also be affected.

78. Because of the nature of the problem, evidence that general credit controls have tended to affect small business more than large firms is difficult to come by and interpret. However, there are obvious reasons why in a period of tight money the short-term finance of small business is likely to be affected more. Firstly, the dependence on bank credit for short-term finance is greater in the case of small business. Hence, even a proportional restriction of bank credit to all business would hurt the small firms more. Secondly, it would appear that in periods of credit restriction bank credit to small business is restricted proportionately more than credit to larger firms. We wish to expand briefly on these points.

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on external sources of short-term finance; and secondly, because among the external sources of short-term finance bank credit is more important for small firms. Established large firms can meet a good part of their needs for short-term finance out of retained earnings or through the greater possibility which they have of shifting financial resources between their longer-term and short-term financial requirements. Also, such firms have access to the open market, both for short-term funds and for longer-term funds which may be used for purposes of short-term financing.

80. For reasons analogous to those outlined earlier in relation to longer-term credit, bank loans to small business as a rule entail more risks than loans to larger firms; also, the expenses of investigating, supervising and administering the former loans are greater. Normally then banks have to charge higher rates of interest on the former loans. Now in periods of credit restriction rates of interest tend to rise. However, for reasons which seem to us historical, and contain little economic or legal justification, there is in Canada a ceiling on interest rates charged by banking institutions. Since the interest charged on credit to small business cannot in periods of tight money exceed the legal ceiling, the differential between the interest rates charged on loans to small and large firms tends to narrow, and, in this manner, loans to

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81. Another reason why tight money affects small business more than large firms is that when credit must be rationed, other things being equal, banks are likely to show preference for the larger firms, which are probably their older, better and more promising clients. The larger firms also enjoy another advantage: open-market credit, to which they (though generally not the small firms) have recourse, tends to be restricted less quickly and drastically.

82. The banks may claim that overall credit tightening does not affect small business any more than it affects large firms - that, when credit is restricted, the restriction is distributed among large and small firms in proportion to the volume of credit they have been receiving. Of course - the banks would point out - the number of small businesses affected will perforce be much larger than the number of large ones, and this might be interpreted as discrimination against small business; also, the mere weight of numbers of small firms affected might impress public opinion unfavourably. The banks may

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83. We have considered carefully the purpose and consequences of the ceiling on interest rates charged by banks. We find little economic or legal justification for it at present, and we recommend that it be raised. Further, we ask your Commission to give special consideration to this problem of short-term changes in the supply of short-term credit to small business. The considerations suggested with reference to changes in the supply of capital to provincial and municipal governments are relevant here also. Small business has not usually been one of the main contributors to sudden inflationary pressures, while on the other hand the development and success of such business is exceedingly important for our economic and social development. It may be necessary to provide for policies and

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techniques of selective control of credit. At present, small businesses are forced over short periods to make more drastic adjustments in their operations than large enterprises. But excessive unevenness in the operations of small firms over short periods tends to knock them off balance, reduces their attractiveness to longer-term capital, and compromises their business prospects and growth potential.

PART V

CONSUMER CREDIT

84. Consumer credit has in the post-war period become an increasingly important part of the Canadian way of life. People used to the vast array of credit facilities open to them in the purchase of homes, durable goods, entertainment and services find it hard to believe that the extensive use of consumer credit is to a large extent a North American phenomenon. We have come to accept the purchase of goods and services through the use of time payment plans, borrowing of funds, credit cards and other devices as essential in our daily lives. To many people credit is simply a convenience as opposed to a means of meeting emergencies, consolidating debts or bringing purchases forward. More than anything else, it is probably the ease with which people can obtain credit financing and the multiplicity of methods open to them that leads to confusion and abuse.

85. One of the key problems which embraces the entire field of consumer credit in Canada is the inability of the individual borrower to determine easily the cost of the credit he is receiving. If the price system is to succeed in efficiently allocating the financial resources of the economy, it is essential that the consumer be able to ascertain the full cost of his credit and be able to compare readily the total lending charges of the various financial institutions. In many situations today,

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financing arrangements are part of a "package deal" and it is difficult to separate financing costs from the actual cost of the good being purchased. In the field of automobile financing, for example, the price of the car is generally lumped with the financing and other charges. The purchaser makes an agreement with the firm which involves the price of the automobile, the financing charges, automobile insurance and a number of other miscellaneous charges. This type of financing arrangement which is practised generally in the retail goods market, makes it virtually impossible for the average consumer to ascertain the actual cost of his using credit, and eliminates the possibility of his being able to compare readily the financing charges of different companies.

86. Moreover, there is little attempt made by the financial institutions to give the consumer a clear idea of the cost of his borrowing. The interest charges of the small loans companies and the chartered banks are lumped together with the regular repayments of principal, and while the total interest and service charges on a particular loan are usually stated in the agreement, the effective rate of interest is rarely mentioned.

87. It is our belief that if the effective rate of interest on the loans of all financial intermediaries providing credit to the consumer are displayed clearly in their literature and their contracts, the consumer will be more readily able to compare the costs of

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borrowing. We, therefore, suggest that the Commission give careful consideration to the methods by which a degree of uniformity might be injected into the credit agreements of the various financial institutions. Of course, the most desirable measure would be to require all the intermediaries supplying credit to the consumer to state in the contract the effective rate of interest on their loans. We understand, however, that even in the more simple cases of credit granted independently of other charges or stipulations it may often be impossible to state unequivocally the effective rate of interest, or it may require mathematical competence of a degree unusual in business. Surely for such cases it should be possible to devise a fairly simple and uniform basis of expressing interest charges, even though this may involve stating a range rather than a single percentage. We urge that it be made compulsory for all institutions extending consumer credit to declare the effective rates or range of rates of interest which they charge on such a comparable basis. It may not matter particularly if the consumer does not know the exact rate of interest which he is paying, but it would help him a great deal if he were enabled to compare and decide where he can get credit most cheaply.

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89. There is one problem related to the operations of small loans companies that we believe should be brought to the attention of the Commission. The statistical evidence of recent years shows that small loans companies have been reluctant to grant loans in the range of $1,000 to $1,500. The companies argue that it costs them more to borrow the necessary funds in the capital market than the interest rate ceiling will permit them to charge on loans in this range. Thus, the pattern has been for the small loan companies to have a large number of loans under $1,000, to discourage loans between $1,000 and $1,500 and to encourage loans in excess of $1,500. We recommend that an appropriate amendment be made to the Small Loans Act.

90. As indicated earlier, we believe that the ceiling on interest rates charged by banking institutions should be raised by an amendment of Section 91 of the Bank Act. It is an unnecessary rigidity imposed upon the capital market. In periods of tight money, when the liquidity position of the banks is low, the interest rate ceiling does not permit the price system to ration the available capital. In our opinion, the argument that the chartered banks are in a monopoly position in many areas of the country and that a ceiling is required, has been virtually destroyed in

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recent years by the rapid growth of other financial intermediaries. Finally, it may at times result in the banks offering a lower rate of interest on savings deposits than they might have to in order to encourage saving.

PART VI

THE FINANCING OF EXPORTS

A The Importance of Exports to Economic Growth

91. Foreign trade has been very important in the economic growth of Canada. Indeed, it may be stated without hesitation that the fundamental stimulus to the development of the Canadian economy in its great periods of forward thrust was provided by the growth of foreign demand for Canadian products. At various times this was due to changes in incomes and expenditure patterns abroad, changes in supply conditions of competing producers, or changes in the means and possibilities of international transportation. Clearly, were it not for the tremendous opportunities provided by foreign trade, Canada might have ranked among the less developed countries. While such has been the importance of foreign trade in the past, the question of practical interest is the role that foreign trade might be expected to play in the future.

92. In some earlier periods of our history, for instance in the late nineteen-twenties, exports of goods accounted for not much less than a quarter of our gross national product, and exports of goods and services for almost three tenths. Recently the relative importance of foreign trade has been substantially smaller, and on the average of the last five years exports of goods have accounted for less than one-sixth of our gross national product, and and of goods and services for almost one-fifth.

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92. In some earlier periods of our history, for instance in the late nineteen-twenties, exports of goods accounted for not much less than a quarter of our gross national product, and exports of goods and services for almost three tenths. Recently the relative importance of foreign trade has been substantially smaller, and on the average of the last five years exports of goods have accounted for less than one-sixth of our gross national product, and of goods and services for almost one-fifth.

This difference has been interpreted rather lightly as indicating that as a country develops and its income per capita rises, the ratio of trade to income must fall. We cannot agree with this view. On the contrary, we would like to emphasize strongly our conviction that acceleration of our rate of economic progress will depend heavily on, and must be accompanied by, a considerable increase in our foreign trade, absolutely and as a percentage of our national income. While domestic investment constitutes a larger percentage of our gross national product than exports, we must remember that much of this investment is export-induced and export-financed, directly and indirectly, and hence it too depends on the changing fortunes of our exports.

93. It is not, of course, our purpose to discuss the gamut of foreign trade problems that have developed since the Second World War. However, we should like to emphasize the role of finance in any national effort to maintain and expand our position as a great trading nation in a world in which trade patterns are changing rapidly. Trade we must, and the effectiveness and expediency with which our financial system can support and promote our efforts to export must be an important yardstick by which we shall measure its adequacy today, tomorrow and for a long time to come.

B <u>Changes in the Demand for Export Credit</u>

94. Generally, it appears that in the past our financial institutions and methods of finance,

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B Changes in the Demand for Export Credit

94. Generally, it appears that in the past our financial institutions and methods of finance,

developed along lines traditional in the Western World, managed to finance our trading activities quite adequately. The great credit which is due to the smooth development and functioning of this part of our economic and financial mechanism and to its role in Canada's economic progress is sometimes forgotten. Wheels that turn well are taken for granted. In any event, conditions are changing and tradition soon turns to being an impediment to progress. There are now some doubts as to whether in recent years our institutions and methods of finance have measured up to the export challenge - whether they have been fully able and prepared to support greater aggressiveness in a field so vital for the Canadian economy. Certainly, neither the present progress of our economy nor our balance of trade and payments problems allow complacency in this matter. Competition in international trade is becoming increasingly complicated and fierce, and in the development of this new trading world there are a few changes that we should like to draw to the attention of your Commission.

95. For a long period in the past the credit required for financing international trade was of short term. When developing countries decided to construct transportation systems, public utilities, power stations or other capital projects and found that their domestic capital resources were inadequate for the purpose, they would first try to secure international loans of a long-term nature, and then use the

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proceeds to finance the capital projects. In sum, it was international investment, not commercial credit, that provided the longer-term capital which was used to finance on a longer term imports of capital or consumer goods related directly or indirectly to development projects.

96. Since the end of the war this two-part operation, of imports of capital in the first place, and goods in the second, has tended to merge. The effort to accelerate economic development has become universal. Both advanced and less developed countries have planned large schemes of economic development and are anxious to undertake large investment projects in transportation, public utilities, industry and agriculture. Import requirements are expanding, and the share of capital goods, construction work and engineering projects in the total imports of many countries has tended to increase. But, while the effort to develop and the need for imports has thus expanded greatly, the international flow of long-term capital is, by almost any conceivable standard, insufficient. As a consequence, governments and private business in importing countries turn to the exporters of the goods and services required to request that they, directly or with the assistance of the government of the exporting country, arrange to provide the credit needed. It is pointed out, of course, that the term of credit should stand in some relation to the earning capacity of the project to be established and the period over which the capital cost of the project is amortized.

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This period is often quite long; for instance, in the case of power stations and grids, steel mills or surveys of natural resources, it may run up to twenty-five years or more.

97. Briefly then, commercial loans, "tied" to the imports of materials, equipment, engineering and other services, and consumer goods from the creditor country, tend progressively to replace the "untied" international loans of older periods. (Since such tied loans are fully respectable, and since they present many advantages for the employment, income and exchange earnings of the creditor country, private interests and government are likely to concentrate more on them and to be correspondingly less anxious to revive and expand portfolio investment abroad of the old vintage). Compared then to the past, export credit generally tends to be of a longer term, including a considerable amount of medium-term credit of one to five years, and long-term credit reaching fifteen to twenty years or more. The length of term of export credit has been added to price, quality, and conditions and date of delivery of the goods as an important feature in the competition for export markets.

98. Another important change in finance of international trade is that, partly on account of the general lengthening of the term of commercial credit, described previously, and partly on account of changes in economic, political and social conditions in the world, foreign trade credit is generally more risky

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than it has been in the past. First, the usual commercial risks, such as the possibility of insolvency or default on the part of the importer, become greater the longer the credit period. Secondly, creditors and exporters are faced with the possibility of political changes, including war or rebellion, currency inconvertibility or non-transferability, changes in exchange or import regulations, changes in exchange rates against which hedging in the forward market may be almost impossible, expropriation or confiscation of private property, and other similar risks, all of them much more serious than before the war. These contingencies would have been less disturbing if trade credit were extended for traditionally short periods.

99. A third important change with which this and other exporting nations have to contend is the emergence and economic expansion of communist regimes. Since one-third of the world's population lives under such governments, the possibilities and advantages of trade with these countries cannot be ignored - nor can we forego our hopes of using trade and other economic and cultural intercourse for advancing world understanding and peace. However, the extension of commercial credit to sovereign governments presents new problems of a substantially different nature than traditional trade credit. When foreign trade is fully a state enterprise, and economic means are used for furtherance of political ends, commercial risks, as usually understood, tend to disappear and are replaced

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by political risks.

C - The Role of Government in Supplying Export Credit

100. The foregoing changes, and others perhaps equally important, have called to question the adequacy of traditional institutions and methods of financing foreign trade. The problems raised are not entirely new, but they still are, and for a long time will be, in the process of being solved. Institutional changes in finance and banking played a very significant role in the nineteenth century, and are likely to do so again in the economic and commercial revolutions of the present and the future. In this and other countries private interests have taken some steps to deal with the new problem of financing export trade. But their action has been timid, and understandably so: for if for a number of obvious reasons private capital is averse to going overseas, why should it go in the form of export credit, which, because of the lengthening of the term of credit, is in effect foreign investment tied to the export of Canada goods? The tying of credit presents advantages to the capital-exporting nations, but not necessarily to its private investors.

101. In several countries government has considered it necessary to enter the field of export finance rather actively: to provide guarantees of export credit and direct facilities for export credit of a longer term. Only thus was it deemed possible for these countries to lengthen credit terms; to insure

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101. In several countries government has considered it necessary to enter the field of export finance [illegible] credit and direct facilities for export credit of a longer term. Only thus was it deemed possible for these countries to lengthen credit terms; to insure

against risks which are privately uninsurable because of the lack of previous experience with a large number of cases, which might have provided the required actuarial background; and to extend credit to sovereign communist and other governments. In the end, governments expect direct benefits in exports, income, employment and foreign exchange earnings. This expansion of government activity in the field of export finance is another one of the important changes which we must draw to the attention of your Commission.

102. Some people claim that this government activity tends to create as many problems as it may solve. They feel that export credit is the preserve of private enterprise - that our export trade has been, and can be, well looked after by our private financial institutions. They claim that government inroads into the field of export finance are undesirable - that government should encourage but not subsidize exports, and should influence but not regulate foreign trade. No doubt, in this spirit your Commission might be able to recommend further ways in which private credit institutions may pool risks, lengthen terms of credit and provide for the extension of credit to communist and other governments. You may even consider various inducements that the Canadian Government may offer in order to promote the new types of export credit required. But, unless your Commission is fully convinced that by such policies and changes we shall be fully able and prepared effectively to face the

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new and increasing competition in international trade, it will have to go further, to explain clearly and emphasize the weighty problem confronting us and to present supplementary or alternative solutions.

103. As indicated earlier, we should try to increase the importance of exports in our gross national product in order to sustain a vigorous economic growth in this country. Our export problem is not so much how to maintain our traditional exports of primary commodities, but rather how to expand our exports of manufactures, which would both make good any shrinkage in traditional exports and provide the growing points of our export trade. Such shifts are the essence of economic progress and change. This distinction between maintaining our exports and providing for the growth of exports is significant. In the case of primary exports, credit of the traditional variety is still largely adequate for the purpose; and there should not be much difficulty in competing with other primary-exporting countries with respect to terms of credit offered - though such exports too, if directed to communist countries, may present a few problems. However, for the growth of our exports we shall depend on exporting manufactures, engineering projects and the like. These are fields in which longer-term credit will be required in competition with the countries of Western Europe and the United States, countries which are proving increasingly aggressive in terms of export credit and export credit guarantee.

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Canadian industry and technology have advanced to the stage where they can supply a considerable variety of these manufactures ~~and~~ services, and it is eminently desirable that we take full advantage of foreign markets. These are fields in which we must get a foot in the door: in the case of many development projects importing countries come to depend on the original supplier for spare parts and replacements, and even equipment in allied uses.

104. There is little doubt in our mind that export credit is developing into a powerful weapon of export promotion, and that the importance of this kind of "tied" international loan will rise in the future. Some people may think it undesirable to see the full power, economic and political, of government closely involved in the export drive of a country. But if this happens in other countries and our private credit institutions are unable to meet the challenge, Canada, dependent as she is on foreign trade, has no alternative but to follow suit - indeed, to try to lead in the game. It is quite possible that we are being forced into a race of exporting by lending. Over the last three or four decades retail business in this and other countries has pushed itself into a position in which its domestic sales, especially of consumer durables, depend heavily on the supply of consumer credit. Perhaps this phenomenon is now being duplicated on somewhat different terms in the international field. Seeing the significance of

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exports for Canadian employment, incomes and the balance of trade and payments, we can ill afford to treat such a development lightly or to be content with half measures.

105. We should like to close these comments with a plea to your Commission to approach the problem of export credit in the right spirit, of aggressive competition. Superficial comparisons and facile conclusions have often been drawn to the effect that exporters in this country enjoy just about as good terms of export credit and insurance as their opposite numbers abroad. We cannot remain content with such platitudes. The question is how we can give the Canadian exporter better terms, that will assist him in capturing new markets. This is the <u>sine qua non</u> of vigorous progress.

106. It has been suggested that at times the volume of individual export business is too small to interest our banks, and that this is particularly true in the case of medium-term credit of one to five years. Individual export orders for light industrial equipment amounting to less than $100,000 have been mentioned. The difficulty of arranging for such credit may be especially great when the exporter is a firm of small or medium size. We hope that your Commission will look into this matter also.

107. The Government of Ontario is very anxious to draw the attention of your Commission to another,

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107. The Government of Ontario is very anxious to draw the attention of your Commission to another,

related, avenue of promoting Canadian employment and growth, while at the same time contributing to the solution of our balance of payments problem. The Canadian market for a large variety of industrial products has grown very significantly in recent years. Our population is in the process of passing the watershed mark of 10-20 million, and our income per head has grown very substantially. The Government of this Province is impressed by the very considerable possibilities which, it believes, exist in this country for producing a great variety of manufactured and semi-manufactured products which are now being imported. We are placing great emphasis on this matter, and we intend to help vigorously in the exploration of every possibility of import substitution, and to support individual efforts in this field by every means at our disposal. While the problems facing our manufacturers may be questions of information, knowledge, technical competence and the like, we believe that special arrangements for credit and guarantee facilities serving this particular purpose would be helpful. In view of the manifold importance of this issue we urge your Commission to give it careful consideration.

D - <u>The Effect of Monetary Policy on Export Credit</u>

108. There are also certain problems of short-term changes in credit conditions and trade credit requirements to which we should like to draw your attention.

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country there is no guarantee that the requirements of our export trade are taken care of. One might argue that if credit is being restricted as part of an anti-inflationary policy in a fully employed economy, credit to exporters may well, or rather should, also be tightened. But if the extension of credit abroad, particularly of a longer term, is becoming as important a lever as it seems to be, restriction of credit over the short period may result in irreparable loss of hard-won export markets. Moreover, it seems that the lessons of the early nineteen-thirties are still to be learned, that credit may have to be tightened in periods of substantial unemployment for balance of payments reasons. At such times it is necessary to make sure that overall credit restriction does not affect export credit, particularly of a longer term. If it does, it may not only entail losses of export markets, but it may also tend to aggravate the unemployment and balance of trade problems. We are implying that in the case of many types of exports the availability and terms of credit may be a more important and immediately effective consideration in foreign markets than the decline in export prices which the tightening of overall credit might bring about. (Of course, credit restriction is expected also to reduce imports). That restriction of credit may have such an adverse effect on exports may be a rather novel contingency. But we may run into foul weather if we delay in recognizing it. Clearly, this is another argument in favour of

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selective control of credit.

110. Problems of financing exports may become even more acute in times of widespread recession. At such times it would be inconceivable to expect our banks or other credit institutions to extend the term of credit - indeed they are likely to do the opposite. Yet, the more prices and exchange rates become inflexible in many exporting countries, the more reliance is likely to be placed for competing abroad during such difficult times on expansion of export credit, on foreign loans tied to exports. In a new type of beggar-my-neighbour game we may be forced into a credit competition in order to support our employment, incomes and foreign exchange earnings. Our export credit facilities and provisions for export credit guarantees will have to be flexible enough to meet the challenge. We trust that in making its recommendations your Commission will emphasize this very significant contingency and make relevant recommendations. More generally, flexibility in export finance to adjust to new requirements and trade alignments will serve us in good stand in the years ahead, in helping to change the direction, nature or pattern of our trade, with a new trading bloc today or a group of state-directed economies tomorrow.

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PART VII

FOREIGN INVESTMENT IN CANADA

111. This Submission would not be complete without some mention of foreign investment in Canada, its importance, the problems it solves and creates, and the attitude with which we should regard the inflow of capital into this country in the future.

A. The Importance of Foreign Investment to Canadian Economic Development

112. Foreign investment has been and will continue to be an essential source of economic development and growth in Canada. It affects the rate and pattern of capital formation, the level of employment and the stability and distribution of our national income. Its effect is felt through its influence on both the supply of and the demand for capital and other resources in this country.

113. The increase in the supply of, and demand for capital and other resources in Canada through foreign investment have made a significant contribution towards accelerating economic growth of this country. Periods of rapid economic development have been associated clearly with high exports, a large inflow of foreign capital and large-scale immigration, the three factors most responsible for Canada's advanced economy and high standard of living. Foreign investment and the consequent increase in the supply of capital have helped Canada to improve the pattern of her economic development, and to reap at an early stage substantial economies of linkage and scale. For a long time the

the economy of this country was characterized by the small scale of many economic operations, including saving and finance. But for the development of our natural resources in particular several important types of large and complex investment projects have been necessary. These projects have required large pools of capital at the disposal of individual firms, as well as considerable risk-taking, advanced technology, and specialized entrepreneurship and management. For these types of investment this country has often had to depend on productive factors which were more appropriate and accustomed to such operations, typically foreign capital, management and technical services. Indeed, because of their size, experience, assurance of export markets for a good part of the output, reliance on foreign sources of supply of materials and parts, and, more generally, good commercial and financial connections and support, the foreign interests found given ventures much less risky than they appeared to Canadians.

114. It is commonly assumed that Canada's dependence on foreign capital will diminish in the future. But the nature and extent of this change, so readily forecast, has seldom been explained clearly or supported convincingly. Qualitatively, we shall very probably depend less on foreign capital. The development of our financial institutions and methods and instruments of finance, the increasing maturity of Canadian industry, and the gradual

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124. It is commonly assumed that Canada's dependence on foreign capital will diminish in the future. But the nature and extent of this change, so readily forecast, has seldom been explained clearly or supported convincingly. Qualitatively, we shall very probably depend less on foreign capital. The development of our financial institutions and methods and instruments of finance, the increasing maturity of Canadian industry, and the greater

removal of certain thinly justified restraints, legal or conventional, on greater participation of our large financial institions and pensions, or other funds in equity investment, are making it increasingly possible for Canadians to concentrate and supply substantial volumes of venture capital. Education, training, research and technical progress in this country should also tend to decrease our dependence on foreign technology and specialized entrepreneurship and management. One may expect also that ways will be found to induce and support the expansion of activities of institutions undertaking longer-term financing of business, and, if necessary, also the development of more and stronger institutions. It is hoped that in a country whose manufacturing and other industry is expanding and should continue to do so, such institutions can be helped to compete more effectively with the banks, insurance companies and other institutions for funds needed for equity investment and more risky ventures.

115. These and other developments in our capital markets, including our institutions and methods of finance, and the increasing maturity of Canadian industry may diminish also our quantitative dependence on foreign capital: a somewhat larger proportion of our capital formation may be financed by domestic capital. However, it is necessary to guard against undue, perhaps superficial, optimism in this matter.

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that as a country developed and its income per head rose, the percentage of its income saved and available for capital formation increased. This has not been the case. Closer and more fundamental examination in recent years, supported by statistical and factual information, has shown the truth of the matter to be quite different. High income per head is not necessarily accompanied by a high ratio of saving to national income - changes in this ratio depend rather on a number of other factors. We conclude that a rich economy like Canada might still depend on foreign investment to a very great extent. Indeed, this dependence is likely to be the greater the more the rate of growth in total national income is raised so that investment becomes a considerably larger percentage of our national income than it has been for the last four or five years. Self-sufficiency in capital requirements is more likely to be achieved in a stagnant Canada, with no immigration, with a low rate of natural increase in population, and with investment in education, health, communications and industry all lagging. In these matters we can afford no mistakes. Erroneous views may be followed by misguided policies regarding foreign investment and lead to very undesirable consequences.

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Foreign capital will be attracted to those countries in which the conditions of demand for it are best. The demand for capital depends partly on the rate of growth of national income and, hence, of the demand for the output of final goods and services. There is no reason why, given appropriate policies, Canada should not be able to achieve as high a rate of growth in national income as any other country. The demand for capital depends further on the supply of important factors of production, such as natural resources, labour of various skills, and managerial and technical services, and with appropriate policies, there is little reason why this richly endowed country should rank second to any other. In addition to the supply of capital, we include among the important conditions enhancing the demand such things as order, good government, political security, and safety of property, conditions usually referred to as "a favourable climate for business." The demand for capital depends also on the economics of scale that capital investment can take advantage of, and, in this respect also, the growing Canadian markets and the proximity of other large markets should provide most attractive conditions. We conclude that there is every reason why this country should be one of the most rapidly expanding areas of the world and one of the most attractive fields for investment of foreign capital. It is a fallacy, as gross as it is common, to believe that the demand for capital is greater in the so-called have-not countries. The <u>need</u> for almost everything

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may be great in those countries. But in most of them the demand for capital and the price they can pay for it are low.

118. In sum, we shall need a substantial volume of foreign capital if we are to accelerate the pace of our economic expansion. At the same time it is clear that our economy can be as attractive to foreign capital as any other country in the world, and more attractive than most. It would be a great pity then if we failed to exploit to the fullest possible extent this opportunity, of securing additional resources for developing our economy and increasing our incomes. It would be tragic if the reasons for our failure were erroneous thinking and faulty policies.

B - The Advantages and Disadvantages of Foreign Investment in Canada

119. The material presented above has been based on the assumption that foreign investment is advantageous to Canadian economic growth. There has been no attempt made to distinguish between the forms foreign investment can take, such as direct and portfolio investment or equity and loan capital, nor the possible advantages or disadvantages that foreign investment may entail. There are, however, pros and cons of foreign investment that should be clearly understood.

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types and distribution of supply of capital in this country through its bearing on factors relating to domestic saving. When foreign investment takes the form of direct investment it often is accompanied by the flow of entrepreneurship, risk-taking, specialized management, technology, skills, and, possibly, valuable patent rights into this country. Another related advantage of direct investment is that the operation of foreign enterprise in Canada has "demonstrated" and "taught" business, productive methods and skills, and has helped to advance the business mentality of this country. Still another advantage of direct investment is that, like the human immigrant, it tends to stay more or less permanently in this country. Moreover, for some years after a new business investment is undertaken there is need for consolidation and growth: profits tend to be ploughed back and servicing of foreign capital on a substantial scale is delayed. Finally in difficult times the service on foreign equity capital tends to decline.

121. Foreign direct investment has presented some disadvantages for Canada. Our natural wealth has attracted foreign capital into our resource industries. In addition, some of our manufacturing industries have attracted foreign capital, partly because of tariff protection and Commonwealth Preference, and partly because of the growth in recent years of some significant domestic markets for manufactures. Foreign investment has tended

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to concentrate in particular industries, and it has in effect dominated a number of mining and manufacturing industries. Outstanding examples of foreign control are found in the rubber, automobile and parts, electrical apparatus, smelting and refining, and petroleum and natural gas industries.

122. While most of the public debate about the disadvantages of foreign investment has focused on the question of foreign ownership, and the problems associated with branch plants in Canada, some people are concerned also about the volume of foreign investment in Canadian fixed-interest bearing securities. Loan capital coming into Canada must be serviced in good times or bad. Further, it has been argued that at times the large-scale inflow of foreign capital into Canada forced the exchange rate up to the point where tariff levels were reduced in effectiveness and Canadian exports suffered. However, the greatest concern arises from the fact that Canada has accumulated an outstanding net foreign indebtedness (including equity capital) of some $18 billion. We have been placed in a position where foreign confidence in the ability of the Canadian economy to meet and repay its foreign obligations is of supreme importance to the future growth and development of our economy.

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justified in using measures which are aimed at safeguarding fundamental national interests. Unfortunately, as we read the record, attacks on foreign investment have all too often been over-emotional, misinformed or in defence of vested interests.

124. It is unfortunate that the attack has been directed also against portfolio foreign investments, notably investment in provincial and municipal bonds. These are types of foreign investment which do not share the disadvantages of foreign business investment to which we referred, especially the so-called "foreign control of important sectors of the Canadian economy." They are precisely the types of foreign investment which, in our opinion, should be encouraged.

125. Clearly, it would be to our advantage if our heavy requirements for investment in human and social capital, detailed in an earlier section of our Submission, could be met partly from abroad. We would be using foreign capital resources to educate our youth, train our labour, build our highways and public works, and construct public utilities and community services. We would be yielding no "control" of any sector of our economy to foreigners, and we would repay later out of the much higher incomes that economic development would bring forth. We repeat that this is a privilege that few countries in the world can hope to enjoy. It would be folly not to take full advantage of it.

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C. - The Need for A Consistent Policy

126. We believe that regarding the problem of foreign capital and business your Commission can perform no greater service than to analyse and explain the role of foreign investment in Canada, in the past and the future. We do not look upon your Commission only as being a body of experts who can produce policy recommendations. We expect that from a position of authority it can "set the record straight" on a number of financial and monetary issues. We hope that in this capacity you will outline clearly the real advantages and disadvantages of foreign investment and of the various types thereof. Also that you will point to the dependence of vigorous Canadian economic expansion in the future on the contribution of foreign capital. We often wonder whether this is sufficiently realized in this country. Above all, we hope that you will make unmistakeably clear the consequences of the alternative policy of "going it alone," of dispensing with foreign capital and therefore the other services which often accompany foreign investment. No doubt this we can do, but only if we opt for a rate of progress far below our economic potential.

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in Canada and abroad about the Canadian attitude towards foreign investment, whether it is welcomed or dammed. And we have witnessed extraordinary gyrations in attitudes and policies: one day foreign capital is suddenly stopped at our border, and foreign business is, in effect, prompted to leave the country; only a few months later a repenting Canada lays out the red carpet.

128. The announcement of a clear and consistent attitude towards foreign capital should go a long way towards bringing the desired results. However, we hope that further steps will be taken in order to bring the declared policy into effect. If as we expect and hope, the approach to foreign investment is intelligently positive, we should expect the Government to remove all unjustified and unnecessary restrictions. We hope that your Commission will study the matter and spell out these obstacles. It is perhaps needless to point out to you that, while over the short-run the withholding tax levied on the interest on provincial and municipal bonds held abroad might seem justified for reasons indicated later, we consider its maintenance over the longer period patently ill-advised. We are looking forward to the earliest repeal of this hindrance to foreign portfolio investment.

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foreign investment in provincial and municipal securities. Our ability to attract capital depends greatly on the structure and functioning of our financial system and on our monetary and exchange rate policies. In view of the great social, economic and political importance of provincial and municipal expenditures, emphasized in an earlier section of our Submission, the success of our financial system and of our financial and exchange rate policies must be judged to a large extent by the measure by which they take care of the needs of provincial and municipal governments and agencies for foreign capital resources.

130. There is not the slightest doubt in our mind that over the long-run Canada stands to gain a great deal and lose very little from foreign investment. However, over certain shorter periods it may be desirable to discourage the flow of foreign capital into Canada.

131. On account of the importance of foreign trade, of the nature of many of our exports, as well as other reasons, this country has been exposed over shorter periods to the impact of declines in business and markets abroad. Our incomes and employment have been, and for the foreseeable future will continue to be dependent on these changes very substantially.

132. Generally, when our economy is in a recession and a significant part of our plants, equipment and

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132. Generally, when our economy is in a recession and a significant part of our plants, equipment and

labour is underutilized or unemployed, imports of foreign capital are less desirable. Such imports of capital amount, in effect, to "importing unemployment": foreign financial resources are being used to buy foreign products, whereas in many cases unemployed Canadian resources could be used to produce substitutes for imported goods.

133. We hope that your Commission will discuss and recommend policies by which this country might or should at various times discourage the inflow foreign capital for limited periods, while adjusting its balance of payments to the change in the conditions and requirements of employment and national income. In the formulation of appropriate monetary, exchange rate and other policies special consideration must be given to the credit requirements and debt service obligations of provincial and municipal governments and their agencies. Inept or haphazard measures may produce a lasting damage to our long-run interests. We cannot help urging again the establishment of machinery for close consultation on these matters between the Federal and Provincial Governments, and the provision for representation of the Provincial Government on the Board of Directors of the Bank of Canada.

Royal Commission
on
Banking and Finance

MR. GRAHAM TOWERS

Hearings
held at
OTTAWA

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SUBMISSION BY

GRAHAM TOWERS

to the

ROYAL COMMISSION ON BANKING AND FINANCE

Some time ago, when I was invited to appear as a witness before this Commission, I asked the Secretary to suggest the subjects on which the Commission might like to receive my comments or opinions. He was good enough to give me a rather formidable list - formidable at least in relation to my resources and capacity. In the end, I have found it necessary to confine my initial evidence to two subjects in which the Commission expressed interest, and to two others that I myself wished to mention.

The first two are:

(1) The composition and role of the Board of Bank of Canada and views as to how their contribution might be strengthened.

(2) The scope of monetary policy - should it be general or both general and specific?

The second group:

(1) The statutory relationship between Bank of Canada and Government.

(2) The statutory provisions covering relations between Bank of Canada and the Provinces.

Before going any further, I would like to present my credentials or perhaps it would be more accurate to say my lack of credentials. Association with Bank of Canada for some twenty years is the only credential of which I am aware. But I must remind the Commission that this association ended nearly eight years ago. At the present time, while I am connected with a number of companies, either as Chairman or Director, this fact has not even a remote connection

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with my appearance here. Opinions which I express will be purely personal.

With these few precautionary observations, let me turn to my first subject - the composition and role of the Board of Directors of Bank of Canada. Views as to the role of the Board logically come first.

I believe that the most important function of the Board is to form opinions on the intelligence, professional competence, powers of judgment and common sense of the management of the Bank. By "management" I mean not only the Governor and Deputy Governors but a number of others whom they will have the opportunity to meet, and who constitute the Bank's resources for the future as well as its strength for the present. If the Directors believe that the quality of personnel is not what it should be, anywhere along the line, it is their duty to express such views and to press for improvement. The Governor is the first man to whom they should speak, but, if the need arises, they are certainly not precluded from discussing the situation informally with the Minister of Finance.

I hope I will be forgiven for making the trite remark that quality of top management is important in any organization, but exceptionally important in the case of a central bank, whose policies can affect the economic life of every Canadian. So to my mind the major role which I assign to the Board - watch-dog of the competence of management - is one of great public importance.

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effectively discharging this responsibility. Anyone who has had much business experience will have known cases where Directors were dissatisfied with management, but, either through timidity or a reluctance to upset the applecart, have refrained from doing anything about, it, except possibly to grumble in private. That is a problem which, potentially at least, faces all Boards, and they must try to cope with it.

I do not believe that Directors must be financial experts or economists in order to perform the duty I have been discussing, although for other reasons the presence on the Board of some men with financial or economic backgrounds could be most helpful. If the Directors are intelligent men of wide experience and independent turn of mind, they will have had many occasions to estimate the quality of others in different walks of life. They will have frequent opportunities to see the Bank management in action, proposing or explaining policies or discussing the results of past actions. If, after a time, they cannot sense weaknesses, if any exist, then their calibre leaves something to be desired. Now it would be Utopian to assume that each and every member of the Board filled my prescription for an ideal central bank Director. If a reasonable number are in this category, they will leaven the mass and set the pace.

While I have taken time to stress what I believe to be the major role of the Board, I do not want to imply that the contributions they can make in other fields are unimportant. They can bring to the

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management information and views from all parts of Canada. They can contribute greatly to morale by their encouragement and support of the Governor and his associates, so long as the management commands their confidence; and they can play their part in appraising the efficiency and economy of the administration of the Bank and the level of salaries.

It will be understood from what I have said that I do not believe it to be the duty of the Board to formulate monetary policy. They should look to management for proposals and recommendations in that field. Obviously they have every right to make criticisms and suggestions and in that connection the presence on the Board of some members with considerable financial or economic knowledge is most desirable. In the final analysis, however, I think that on questions of monetary policy the Board must depend heavily on the Governor - again so long as he commands the Board's confidence.

It must be remembered that monetary policy at any given time may be influenced by fiscal policy, present and prospective, or by foreign exchange policy, present and prospective. The Governor should always be aware of the Government's present position and future intentions in these fields, but, so long as they are not a matter of public knowledge, he cannot or should not transmit information to anyone other than officers of the Bank who need to know because of the duties they perform.

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when I felt somewhat embarrassed by the fact that I could not give the Board a complete explanation of the reasons for certain proposals, because they were partly based on actions which the Government expected to take but which were still categorized as secret. When these Governmental decisions became public property, and particularly if this took place shortly after a Board meeting, I know that some Directors did not relish the thought that they had conducted discussions while partly in the dark. I do not think there is any solution to this problem. But if it is accepted that the major role of the Board is the one I have suggested, there is no real cause for embarrassment.

The Commission has received various suggestions in regard to the composition and numbers of the Board of the Bank. In some that I have read, the view is expressed that only men with experience and skill in financial and economic matters should be appointed. I sense that the recommendations that the principle of regional representation should be abandoned and that the number of Directors should be reduced are inspired in part at least by the feeling that it would be extremely difficult to find twelve men with the skills mentioned a moment ago, particularly if the Government had to have regard to their places of residence.

As I mentioned earlier in my remarks, I am all in favour of the presence on the Board of some men who have high competence in financial and economic matters but I believe that restriction of membership to people

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in this category would, in fact,weaken the collective wisdom and standing of the Board. This opinion is, of course, influenced by the views I have expressed in regard to the role of the Board.

The basic fact is that appointments to the Board have to be made by Government. No form of legislation can ensure the appointment of first-class Directors but nothing in the present Act prevents it. For my part, I see no point in changing the Act in an endeavour to accomplish by legislation something which inevitably depends on the wisdom of Government.

The second subject on which I am to comment is the scope of monetary policy - should it be general or both general and specific? As a preface to my remarks, I propose to quote some evidence I gave to the Standing Committee on Banking and Commerce on May 5th, 1939.

(Minutes of Evidence - pages 368 and 369)

"The last point which I would like to mention concerns central banking activities of a general character. In speaking of this - very briefly - I will not try to define exactly the things in which a central bank might interest itself. One might say either that nothing is the bank's business, or that everything is its business. The bank must try to maintain a reasonable balance in that respect. It should not entertain the thought that it should have a finger in every pie, but it certainly must neglect no opportunity to make suggestions or give a lead when its knowledge of a situation gives

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it reason to believe that such action would be in the public interest. Its closest connection is likely to be with the financial activities of its market - with the operation of the stock and bond markets as well as with the business of the commercial banks. It is deeply interested in the machinery by which the savings of the people are mobilized and invested. Moreover, it cannot fail to be concerned with the progress and development of industry in general. If the bank has reason to believe that unsound developments are taking place, or unsatisfactory practices are being followed in any important department of the Canadian economy, it must try to find an opportunity to make suggestions which will bring about an improvement. I do not suggest for a moment that the central bank has superhuman intelligence, but a central bank is in a better position to accomplish something than any individual can be. Naturally, successful prosecution of activities of this character depends on experience and the wisdom and prestige which come with it. Ill-considered action, or an attempt to cover too wide a field, are equally fatal."

In expressing an opinion on whether monetary policy should be general in character or both general and specific, I am interpreting "specific" to mean efforts by the Bank to secure certain desired results by moral suasion. Incidentally, there have been objections to this phrase, but, as it has been employed by the Bank of Canada in its submission to the Commission,

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I feel reasonably safe in following suit.

It will be seen from my remarks in 1939 that I am in favour of the use of moral suasion to promote specified policies, provided that the occasions on which this is done are restricted by prudence and common sense. However, there are certain alternative courses of action which should be examined.

(1) One such would be for the Bank to confine itself strictly to the exercise of the powers found in the Act. In order to influence cost and availability of credit, the Bank would rely on its ability to determine the cash reserves of the chartered banks and so - within narrow limits - the total volume of bank credit outstanding. When such credit reached a level beyond which the Bank thought it unwise to go, for the time being, the Bank would not be directly concerned if pressing demands for loans for stock market or other speculation, instalment finance, or term loans to large corporations, were tending to freeze out other borrowers, or if the banks were reducing their liquid positions to a level not much in excess of statutory reserve ratios. My own opinion is that such a course of action would at times produce an unnecessarily difficult situation for the mass of borrowers, would contribute to undue fluctuations in business and, incidentally, to serious criticism of the banking system.

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individuals is intense and banks will go to almost any lengths, within their concept of safety, to prevent competitors from capturing such accounts or the accounts of individuals who can influence the transfer of business. The banks may feel that their advances in a particular category are increasing beyond reasonable bounds (although probably safe) and rendering it more difficult for them to cater properly to all their clients. Left to themselves, however, they will have great difficulty in calling a halt,at least until the extreme point is reached where they have literally no further ability to lend.

It is not just a desire to reminisce which makes me hark back to the situation in 1928 and 1929. One of the disasters of that time was the enormous increase in the volume of bank credit for stock market speculation. Bank presidents and general managers spoke of this danger in addressing their annual meetings as early as 1928, if my memory serves me right. The practical results of these warnings were not visible to the naked eye, as loans continued to mount until the crash came in the autumn of 1929.

If there had been a central bank at that time, I am sure that the Governor could have rendered a great service, say, early in 1928, by proposing to the banks a restriction on credit for the purchase of stock market securities. He would not have been more percip-ient than many of the commercial bankers, who were admittedly worried about the excesses of the time. I believe the bankers would have received him with open

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arms and that such an arrangement could have been made to work to the advantage of the country. General managers would have been able to say to important clients who were being refused accommodation that the reason was to be found in the agreement sponsored by the Bank of Canada. The Governor could have been the whipping boy - a useful function which he has performed on various occasions since 1935.

As a postscript I must add that the extension of credit in the late '20's could not have been so great if the banks had not been able to borrow freely under the Finance Act. A central bank might well have kept them on a tighter rein, although I have my doubts as to whether that alone would have dealt effectively with the problem of credit for speculative purposes.

(2) Another course of action would be for Bank of Canada to eschew moral suasion but for the Government to step into the breach. This would not meet the criticism that actions were being taken without authority from Parliament, unless, in fact, Parliament conferred such authority to regulate activities in certain financial fields. The authority would obviously have to be very general in character and for that reason quite dangerous - or so I believe. I much prefer persuasion to coercion in dealing with the too little understood field of credit policies.

I should state here my assumption that attempts at moral suasion by Bank of Canada will be directed in most cases to the chartered banks. The Bank of Canada

does not go to them as a dictator and, unless a responsible majority of the bankers feel that the action proposed is in the public interest and not seriously prejudicial to the banks, the Governor will not get an agreement.

Furthermore, I assume that the Minister of Finance will always be aware of proposals which are being made by Bank of Canada. He will not be asked for formal agreement, so that his prestige and that of Government is not engaged. But his tacit blessing is required. Finally, let me say that I do not overlook the pitfalls lying in the path of anyone who attempts qualitative control of credit. In the final analysis, over-all monetary and fiscal policy must do the job. But I believe there can usefully be some rare, temporary and prudent exceptions to this rule.

I propose now to comment on the statutory relationship between Bank of Canada and Government. The Commission will, of course, understand that I am not concerned with the sections of Bank of Canada Act which deal with the Bank's powers to make loans to the Federal Government or with information which has to be given to the Minister of Finance, and so forth, but rather with the major question of responsibility for monetary policy. The Act places this responsibility on the Governor and Directors of the Bank and is silent about the position of Government in this field.

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I hope that the Commissions' patience will not be tried if for a second time I quote some remarks I made to the Standing Committee of the House of

Commons on Banking and Commerce. The date was March 18th, 1954, and, as the text will indicate, I was speaking extemporaneously in reply to a question.

(Minutes of Evidence - pages 25 and 26)

"The situation is that parliament has placed squarely on the shoulders of the directors and management of the Bank of Canada the responsibility for monetary policy. It would be of no use for us to come before a committee of this kind and say in respect to certain actions which were criticized, we did not like that, but the government wanted us to do it. The proper question would be; in what Act has parliament said that you should do something in the field of monetary policy in which you do not believe? Therefore, we must and do take full responsibility for everything which we have done. Now, I think myself that the Bank of Canada Act is in this respect a very good Act, and better than most, because it is clear. There is no alibi possible for the central bank."

"On the other hand, there is no alibi possible for the government, because if government said: well, we disagreed with what the central bank did, but parliament has placed the responsibility on them, so what could we do? The answer obviously is that the administration of the day, supported by a majority in parliament, can always alter the legislation. In fact, I doubt whether a disagreement would ever necessitate such a thing, because there are various ways and means by which

directors and management can be got rid of. I am sure that in the case of a serious disagreement that is what would take place. There is a long history behind this thing in central banking - and I assure you I won't take up much more of the committee's time - but in the days when kings and princes ruled the roost, they had rather a nasty habit of debasing the coinage when they got into a fix, and even later on parliamentary governments sometimes did the same thing, in the modern sense of inflation. Therefore, it is interesting to notice that in all the many countries of the world - I think it is 60 or more which have central banks - they have always been set up not as a department of government but as separate institutions. In many cases, they have altered in form through the years, and with hardly an exception they have been nationalized, but they have been left as separate structures with the idea that then there are certain checks in respect to the possibility of doing that insidious thing which not one person in a million understands, debasing the currency. In some cases, of course, the independence, while intended to be encouraging to the public, is a pure facade. Obviously that is so in a totalitarian state. But even in some other places in recent years there have been governments - we have had them in sister countries of the commonwealth - which felt that they could not bear the thought that even for a day someone should frustrate or delay the policy

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of the administration of the day. So on top of the facade which, so far as the public is concerned was supposed to convey an idea of check and balance and independence, they would write in a clause saying the policy of the central bank shall be that dictated by the Minister of Finance from time to time. Myself, I think that that is a sort of mongrel arrangement, and the central bank should be either a pure department of government and known to the public as such, or it should have independent responsibility."

"Just to make sure that nothing I have said conveys a misunderstanding, I would like to add that no central bank, and certainly not the Bank of Canada has any delusions of grandeur or any thought that it has sovereign power. That always lies with the administration which commands a majority in Parliament."

While I quote my evidence in 1954, I had expressed similar opinions on other occasions, commencing shortly after the creation of the Bank in 1935.

It is obvious that the legislation in its present form is satisfactory only if both Bank and Government understand and accept the dual responsibilities to which I referred. For a considerable number of years no difficulties or misunderstandings developed. Various Ministers of Finance put their position on the record, clearly stating that the Government had

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the ultimate and overriding responsibility for monetary policy. More recently it appeared for a time to be the view of Government that they did not in fact have this responsibility, because no specific reference was made to it in the Act. Still more recently, the Government has again shouldered its burden. I should think it would now be extremely difficult for any Government to revert to the position that it was powerless in this field.

While I continue to believe that the present Act is soundly conceived, I recognize that there exists a body of respectable opinion favouring an amendment which would give the government power to dictate policy; and I am aware that provisions of this character have been incorporated in the central banking legislation of a number of countries. My concern is to preserve the responsibility for monetary policy now placed on the Governor and Directors so that they could not, except at the expense of their integrity, implement a policy which they believed to be bad for Canada. The whole point in setting up a central bank as an independent organization is to protect the public and to provide means for warning the public if serious disagreements arise. If the independence of the central bank is purely a facade, one gets the worst of both worlds.

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It is, I think, interesting to consider the legislation on this subject in some other countries. In the United Kingdom and the Netherlands the Government can issue directions to the central bank without being bound to make such directions public. In Germany, on the other hand, the legislation, as I understand it, is similar in effect to the present Bank of Canada Act. Germany's experiences in the monetary field have been such that they attach great importance to the protection that an independent central bank can provide, so long as Parliament allows it to operate as such.

In New Zealand, where the Act was amended in 1939, to give the Government power to decide central bank policy, a further amendment in 1950 took the power away from the administration of the day and put

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In Australia, the procedure for dealing with differences of opinion between the central bank and Government is carefully prescribed, the final say lying with Government. But in the event of a written directive having been issued by the Government, full information has to be given to Parliament within fifteen sitting days.

If it is decided that there has to be legislation of this character in Canada, it seems to me that the Australian formula is the least harmful, although I would prefer a stipulation that directives to the Bank had to take the form of Orders in Council and that Government had to make its actions known to the public at once rather than after what might be a delay of months.

I am certain what central bank Governors would feel their course of action should be after receiving instructions to follow a policy which they had strongly opposed. Legally, they and their Boards are absolved from responsibility. So far as I am aware, there are not yet any precedents, so the question must go unanswered.

Before finishing my remarks on this subject, I want to make a brief reference to the powers of the Board of Directors of Bank of Canada. Under the Act as it stands, any member of the Board, including the Deputy Minister of Finance, is entitled to propose that the Bank should do certain things, or adopt certain policies. If the majority of the Board

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(excluding the Deputy Minister of Finance) agrees, their decision is binding, subject to the veto of the Governor. The Governor in Council has power to override such a veto. It follows that, if there are unresolved differences of opinion between Bank and Government on matters of Policy, the Bank of Canada view, if it is to prevail even temporarily, must be supported not only by the Governor but by a majority of the Directors appointed by Government.

May I turn now to the statutory provisions covering relations between Bank of Canada and the provinces.

Section 20, sub-section (1) of the Bank of Canada Act reads as follows:

"The Bank shall act as fiscal agent of the Government of Canada without charge and, subject to the provisions of this Act, by agreement, may also act as banker or fiscal agent of the government of any province."

During the first twenty years of the Bank of Canada's existence, no Province requested the Bank to act as its banker or fiscal agent. I do not know what, if any, discussions may have taken place between the Bank and Provincial Governments since the end of 1954. In any event, the Bank is not at the present time functioning as banker or fiscal agent for a province under the terms of Section 20, sub-section (1) of the Act.

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various provinces. The view expressed by the Bank was that no good purpose would be served unless a provincial government felt that it desired a continuing close collaboration with the Bank and in that connection was prepared to keep the Bank fully informed at all times in regard to its financial position and requirements, present and prospective. The Bank indicated that it would undoubtedly be prepared at appropriate times to make temporary advances to provinces or to purchase provincial securities, provided that the size of such operations did not clash with the Bank's primary responsibility for regulating credit and currency in the best interests of the economic life of the nation. During the discussions, however, it was indicated that a province should not feel that the main value of the connection lay in the possibility of securing financing from the central bank.

I think it is not surprising that no provincial government - at least up to 1954 - asked the Bank to become its banker or fiscal agent. An intimate relationship with a creature of the Federal Government might at times be a political liability for a province. My impression was that no provincial Premier would take this risk, if the principal benefit to be expected was the receipt of advice. Advice, particularly good advice, can be embarrassing.

From the point of view of Bank of Canada also the relationship would be a most difficult one. It is hard enough on occasion to co-ordinate the monetary policy of the Bank with the fiscal and debt-management

various provinces. The view expressed by the Bank was that no good purpose would be served unless a provincial government felt that it desired a continuing close collaboration with the Bank and in that connection was prepared to keep the Bank fully informed at all times in regard to its financial position and requirements, present and prospective. The Bank indicated that it would undoubtedly be prepared at appropriate times to make temporary advances to provinces or to purchase provincial securities, provided that the size of such operations did not clash with the Bank's primary responsibility for regulating credit and currency in the best interests of the economic life of the nation. During the discussions, however, it was indicated that a province should not feel that the main value of the connection lay in the possibility of securing financing from the central bank.

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From the point of view of Bank of Canada also the relationship would be a most difficult one. It is hard enough on occasion to co-ordinate the monetary policy of the Bank with the fiscal and debt-management

policies of the Federal Government. If the Bank was involved in responsibility, directly and indirectly, for the financial activities and credit requirements of provinces, its problems would be such that I do not believe it could render good service to all its governmental clients. Inevitably the primary concerns of the Bank must be the credit needs of the country as a whole and the fiscal problems of the Federal Government. Conflicts of interest might well arise, and provincial governments would be aggrieved if they came to feel that their interests were subordinated to other considerations, no matter how important these considerations were, from the point of view of the Bank and the Federal Government.

There is still another possible source of difficulty and embarrassment. Under Section 20, sub-section (1) of the Act, the Bank must act as fiscal agent of the Government of Canada. It has no choice. But the performance of this function for a province is a matter of agreement. If the Bank felt that a province's financial policies were leading it into serious trouble, and its advice in this connection was rejected, it could not in good conscience continue to be publicly associated with the province in question as banker and fiscal agent. I think that in such circumstances the Bank would have to terminate the arrangement, an action which would have a bad effect on the province's credit standing, at least in the short term.

Those who were responsible for drafting the

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Those who were responsible for drafting the

original Bank of Canada Act in 1934 undoubtedly felt not only that a central bank was essential to the proper functioning of Canada's monetary system, but also that the bank could be of great help to the Federal Government in its capacity as adviser and collaborator on debt management.

They also believed that it would be good for provincial governments, if they so desired, to receive objective and impartial financial advice from a competent authority, not commercially involved in the business of buying and selling securities. In my opinion, they were right in thinking that this need existed. However, for reasons which I have cited, I doubt that the central bank can effectively respond to this need or that it will be asked to do so on any basis which would offer prospects of successful co-operation.

I should imagine that any competent economist could make out a strong case for a considerable degree of co-ordination in the financial activities of the various governmental authorities who between them take from the Canadian people a high percentage of the national income. If such a development should ever take place, I think that new organizational arrangements would have to be devised, with the central bank acting as an indispensable collaborator, but not as the spear-head.

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In my experience, the reference to provinces in Section 20, sub-section (1) of the Bank of Canada Act has over the years given rise to various

difficulties and misunderstandings. If the authority granted in that Section is not likely to serve any practical purpose in the future, the Commission may wish to consider the advisability of recommending a change in the Act.